83-991

No. ____

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ALUMINUM COMPANY OF AMERICA and
TAPOCO, INC.,

Petitioners,

—v.—

UTILITIES COMMISSION OF THE STATE
OF NORTH CAROLINA, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTIONS PRESENTED

1. Did the Court of Appeals incorrectly extend the "abstention" doctrine articulated by cases such as *Younger v. Harris*, 401 U.S. 37 (1971), and *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), when it affirmed the dismissal of petitioners' complaint alleging that a state utility commission had contravened both the Commerce Clause and the preemptive federal regulatory scheme of the Federal Power Act by attempting to give local consumers "first call" on inexpensive hydroelectric power sold in interstate commerce?

2. Should the Court grant this petition for a writ of certiorari to resolve the conflict between the Fourth Circuit's decision in this case, and the recent decisions of the Third Circuit (in a case in which this Court has noted probable jurisdiction), and of the Second and Ninth Circuits, that the doctrine of abstention may not properly be invoked when a federal plaintiff alleges that a state agency or official has violated a preemptive federal statutory scheme?

3. Assuming *arguendo* that the abstention doctrine may properly be invoked in a case in which a plaintiff asserts claims based on federal statutory preemption, did the Court of Appeals adopt an erroneous legal standard for determining whether abstention was appropriate, when it failed to balance the competing interests of the federal and state governments in the resolution of petitioners' preemption claims, and instead affirmed the dismissal of petitioners' complaint solely on the ground that the District Court could not adjudicate petitioners' preemption claims without deciding disputed questions of fact?

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Robert K. Koger, Leigh H. Hammond, Sara Lindsay Tate, John W. Winters, Edward B. Hipp, A. Hartwell Campbell and Douglas P. Leary (who were made parties in their respective official capacities as chairman and commissioners of the North Carolina Utilities Commission), the State of Tennessee, and the Tennessee Office of Community and Economic Development are respondents. Rufus L. Edmisten, who is the Attorney General of North Carolina, and the United Steelworkers of America, AFL-CIO, and its Local Union 309, submitted briefs as amicus curiae in the Court of Appeals.

STATEMENT PURSUANT TO RULE 28.1

Petitioner Tapoco, Inc. is a wholly-owned subsidiary of petitioner Aluminum Company of America.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Aluminum Company of America ("Alcoa") and Tapoco, Inc. ("Tapoco") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix A, *infra*, 1a-12a) is reported at 713 F.2d 1024. The opinion of the District Court (Appendix D, *infra*, 17a-30a) is not reported.

JURISDICTION

The judgment of the Court of Appeals (Appendix B, *infra*, 13a-14a) was entered on July 28, 1983. A timely petition for rehearing was denied on September 21, 1983. (Appendix C, *infra*, 15a-16a) The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case does not involve the construction or application of any constitutional or statutory provisions.

STATEMENT OF THE CASE

A. The Nature Of The Case

In recent years, this Court has taken a number of opportunities to consider the proper relationship of the federal courts to the state courts. The Court's decisions have created an evolving "abstention" doctrine, which counsels the federal courts against interfering unnecessarily with proceedings in the state courts that concern matters primarily of local concern. *See, e.g., Younger v. Harris*, 401 U.S. 37 (1971); *Middlesex County Ethics Committee v. Garden State Bar Ass'n*, 457 U.S. 423 (1982). *Cf. Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.*, ____ U.S. ____, 103 S.Ct. 927 (1983).

While the Court has recognized the importance of deferring to the state courts when important state interests are involved, the Court's recent decisions have also strongly reaffirmed the supremacy of federal substantive law in areas which, under the Constitution, are matters of federal concern. In particular, this Court has recently invalidated, as repugnant to the Commerce Clause, a state's efforts to give its own citizens preferential access to electric power generated within the state's borders, *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), and the Court has unambiguously upheld the power of Congress, acting pursuant to the Commerce Clause, to enact statutes preempting state regulation of the generation and sale of electricity in interstate commerce. *F.E.R.C. v. Mississippi*, 456 U.S. 742 (1982).

In this case, the important policy considerations underlying these two lines of precedent have needlessly come into conflict. As will be described below, the controversy arose when respondent North Carolina Utilities Commission ("NCUC") adopted an administrative order which had the stated purpose of giving North Carolina residents "first call" on the low-cost

hydroelectric power generated by Tapoco at its dams in North Carolina and Tennessee, thereby depriving Alcoa and the State of Tennessee of the benefits of this scarce natural resource. Alcoa and Tapoco brought suit in the District Court to enjoin the enforcement of the NCUC's order, alleging that the order impermissibly burdened interstate commerce and conflicted with the preemptive statutory scheme of the Federal Power Act. Although petitioners' lawsuit only raised questions of federal law, the Court of Appeals held that the federal courts should abstain from adjudicating their claims. It accordingly affirmed the dismissal of petitioners' complaint, forcing Alcoa and Tapoco to litigate their federal claims in the state courts.

B. Underlying Facts

Alcoa operates an aluminum smelting operation in Blount County, Tennessee (hereinafter, Alcoa's "Tennessee Operations"). Alcoa's subsidiary, Tapoco, supplies electric power to Tennessee Operations. Tapoco operates four hydroelectric generating stations in North Carolina and Tennessee. Tapoco's hydroelectric stations have been duly licensed by the Federal Energy Regulatory Commission ("FERC") (formerly the Federal Power Commission), the federal agency with exclusive jurisdiction under Part I of the Federal Power Act, 16 U.S.C. § 791 *et seq.*, to approve the construction of dams on navigable waters within the United States.[1]

Another Alcoa subsidiary is Nantahala Power & Light Company ("Nantahala"). Like Tapoco, Nantahala operates a number of federally licensed hydroelectric projects. However, unlike Tapoco, Nantahala operates as a public utility, serving six counties in western North Carolina. Since 1971, Alcoa's Tennessee Operations has purchased no electric power from Nantahala, and Nantahala's hydroelectric facilities, con-

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1 *See, First Iowa Hydroelectric Cooperative v. F.P.C.*, 328 U.S. 152 (1946). Tapoco's federal license for its hydroelectric projects recognizes that all hydroelectric power generated by Tapoco will be used to supply Alcoa's Tennessee Operations. *Tapoco, Inc.*, 14 F.P.C. 610, 612-13 (1955).

structed with capital provided by Alcoa, have been totally dedicated to serving Nantahala's public utility customers.[2]

Because the dams owned by Tapoco and Nantahala are located on the watershed of the Little Tennessee River, Section 26a of the Tennessee Valley Authority Act of 1933, 16 U.S.C. § 83ly-1, required that the Board of Directors of the Tennessee Valley Authority ("TVA") approve the way in which the dams were operated and maintained. In compliance with this requirement, Alcoa, on behalf of itself and its subsidiaries, entered into an agreement with TVA known as the "Fontana Agreement of 1941," which was essentially superseded in 1963 by a "New" Fontana Agreement. These agreements gave TVA the right to control the discharge of water at the Alcoa subsidiaries' dams, which allowed TVA to coordinate the operation of those dams with its own facilities. The agreements also provided that all electric power generated at the dams owned by Nantahala and Tapoco would be delivered to TVA, to be dispatched by TVA over its interstate transmission grid. In return, TVA agreed in the New Fontana Agreement to provide the Alcoa subsidiaries with fixed "entitlements" of electric energy, regardless of the amount of energy which Tapoco and Nantahala actually delivered to TVA. The "entitlements" of energy from TVA were divided between Tapoco and Nantahala pursuant to an "Apportionment Agreement" which those two companies executed in 1971.

By the late 1970's the "entitlements" of energy which Tapoco and Nantahala received from TVA came to be of great

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2 Prior to 1971, when Nantahala's service area was more sparsely populated than it is today, Alcoa's Tennessee Operations acted as a "customer of last resort" for Nantahala by purchasing any power which was not necessary to serve Nantahala's public utility customers. These purchases helped to defray Nantahala's costs of providing service. By supplying the capital necessary to construct Nantahala's hydroelectric facilities, and then helping to amortize these investment costs by purchasing Nantahala's excess power for Tennessee Operations, Alcoa conferred a significant economic benefit on Nantahala's customers who, as the direct result of Nantahala's present ability to generate low-cost hydroelectric power, enjoy one of the lowest rates for electric service in the nation.

economic value, because the hydroelectric generating costs associated with these entitlements were significantly lower than the costs of generating power by any alternative means. Under the two agreements, Tapoco did not receive enough power as "entitlements" to satisfy fully the demand of Alcoa's Tennessee Operations, nor did Nantahala receive enough power to serve all of its customers' needs. Both Alcoa and Nantahala therefore had to purchase relatively expensive supplemental power from TVA.

The New Fontana and Apportionment Agreements were agreements for the sale of electric power at wholesale in interstate commerce, and the FERC therefore had exclusive jurisdiction under Part II of the Federal Power Act, 16 U.S.C. § 824 *et seq.*, to determine whether the terms of those agreements were just and reasonable.[3] The reasonableness of the two agreements was fully considered by the FERC, in a proceeding in which the Attorney General of North Carolina participated as the representative of the ratepaying public of North Carolina. *Nantahala Power & Light Co.*, FERC Docket No. ER76-828. After hearing, the FERC corrected certain minor inequities allegedly resulting from the Apportionment Agreement, but otherwise found the two Agreements to be fair and reasonable.[4]

Although the NCUC has been preempted by the Commerce Clause and the Federal Power Act from adjudicating the

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3 Part II of the Federal Power Act was enacted to fill the regulatory gap created by this Court's decision in *P.U.C. v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), which held that Commerce Clause prohibited the states from regulating interstate wholesale transactions in electric power. In enacting Part II of the Federal Power Act, "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction. . . . This was done in the Power Act by making [FERC] jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the states." *F.P.C. v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964).

4 Nantahala, the North Carolina Attorney General, and other interested parties have appealed the FERC's decision to the Fourth Circuit. *Nantahala Power & Light Co. v. F.E.R.C.*, Case No. 82-1872, and related cases.

reasonableness of the New Fontana and Apportionment Agreements, it has jurisdiction to regulate Nantahala's rates to its local retail customers. Prior to the order which precipitated this litigation, the NCUC had always accepted the costs and allocations of power established by Nantahala's federally regulated agreements as binding on the NCUC when it established Nantahala's retail rates. However, in 1980, the Supreme Court of North Carolina reversed the NCUC's decision in a Nantahala rate case, with instructions that the NCUC determine on remand whether a different methodology would be "in the best interest of the [North Carolinian] customers of Nantahala." *State ex rel. Utilities Commission v. Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980).

On remand, a panel of the NCUC, composed of respondents Tate, Campbell and Leary, entered an *Order Reducing Rates and Requiring Refunds*, dated September 2, 1981. Relevant portions of this order are submitted as Appendix E to this petition. (31a-74a). In its order, the NCUC panel arrogated to itself the FERC's exclusive jurisdiction to determine the reasonableness of the New Fontana and Apportionment Agreements, and purported to find that those agreements contained "a number of inequities" to Nantahala and "concealed benefits" to Alcoa. (37a). The NCUC rejected the ratemaking methodology proposed by Nantahala because that method was "based in all material respects upon demand and energy entitlements as described and set forth in the [federally regulated] New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement." *Id.* In place of a methodology based on Nantahala's FERC-regulated agreements, the NCUC panel substituted its own method which was "based in all material respects on the assumption" that Nantahala's customers had "first call on the total electric energy output" of both Nantahala and Tapoco. *Id.* The NCUC panel conceded that its order had the economic effect of reforming the parties' federally regulated agreements, stating that its ratemaking methodology "avoids the need for complete identification of inequities and is nicely suited as a proper alternative to reformation of contracts." (56a).

After this litigation was commenced in the District Court, the full NCUC affirmed the panel's order. The NCUC ordered Nantahala to make refunds in excess of $18 million, and held Alcoa liable for these refunds to the extent that Nantahala was financially unable to pay them. Because Nantahala lacks the resources to pay more than a small fraction of the refunds, most, if not all, of the refund obligation the NCUC has imposed will be borne by Alcoa.

C. Proceedings Below

On January 26, 1982, Alcoa and Tapoco brought suit against the NCUC and its members in the District Court.[5] Their complaint alleged, *inter alia*, that the NCUC's orders placed an impermissible burden on interstate commerce and conflicted with the preemptive authority of the FERC under the Federal Power Act.

Defendants moved to dismiss the complaint. Alcoa and Tapoco moved for summary judgment, taking the position that it was clear from the face of the NCUC's orders that the NCUC was improperly attempting to give Nantahala's customers "first call" on Tapoco's hydroelectric power in contravention of the preemptive federal regulatory scheme.

On July 29, 1982, the District Court, Honorable Franklin T. Dupree, Jr., ruled on the outstanding motions. The District Court held that it had subject matter jurisdiction under 28 U.S.C. §§ 1331 and 1337. It further held that the Johnson Act, 28 U.S.C. § 1342, which in certain enumerated instances prevents the federal courts from enjoining the enforcement of state ratemaking orders, did not apply. See p. 16, *infra*. However, relying principally on the *Burford* and *Younger* abstention doctrines, more fully discussed *infra*, the District Court ruled that it must abstain from exercising its jurisdiction, because "[c]onsideration of the federal [preemption] questions . . . would require detailed factfinding concerning

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5 The action was originally brought in the Eastern District of Tennessee but was transferred by that court, on defendants' motion, to the Eastern District of North Carolina. See 548 F. Supp. 18.

the indirect effects of the NCUC rate and refund orders on interstate commerce, on the rates established by the FERC, and on contracts filed with the FERC." (29a). It therefore dismissed the complaint, leaving Alcoa and Tapoco no option other than to pursue their federal claims in the North Carolina state courts.[6]

On appeal, the United States Court of Appeals for the Fourth Circuit, per Honorable Sam J. Ervin, III, affirmed both the District Court's holding that it had jurisdiction, and its holding that it should abstain from exercising that jurisdiction. The Court of Appeals "decline[d] to adopt . . . a *per se* rule" that "abstention is never appropriate where the federal plaintiff asserts a preemption claim." (12a). The court accepted, without analysis, the District Court's finding that "[e]valuation of the preemption claim would involve detailed factfinding . . ." *Id.*[7] Relying principally on the *Burford* abstention doctrine, the Court of Appeals concluded that "the

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6 On December 6, 1983, well after the decision of the Fourth Circuit in this case, North Carolina's intermediate appellate court affirmed the NCUC's orders in all respects. Although the federal courts had held that the federal issues raised by Alcoa and Tapoco could not be resolved without "detailed factfinding," the North Carolina Court of Appeals rejected the federal preemption arguments without making any factual findings of its own, or remanding the case to the NCUC for further development of the factual record.

7 Although petitioners do not seek review on certiorari of the Court of Appeals' holding that "detailed factfinding" would be necessary to adjudicate their federal claims, they believe this holding to be clearly erroneous. This holding, which the Court of Appeals uncritically adopted from the District Court's opinion, was based on the District Court's erroneous view that there was "no controlling authority for the proposition that the NCUC is bound to accept in its independent regulatory bailiwick a rate of purchasing electricity approved by FERC as Nantahala's cost of service." (29a). The law, however, is clearly to the contrary. *F.P.C. v. Southern California Edison Co., supra. See, e.g., Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (S.Ct. R.I. 1977), *cert. denied.*, 435 U.S. 972 (1978). Once it is recognized that the NCUC *must* accept, for its own ratemaking purposes, the terms of federally-regulated power supply arrangements, it becomes undeniably apparent, from the language of the NCUC order quoted above, that the NCUC has refused to accept the full preemptive effect of federal regulation.

federal court need not engage in such factfinding as a prerequisite to abstention." *Id.* In so holding, the Court of Appeals, like the District Court, made no attempt to weigh or balance the relative interests of the state and federal governments in the resolution of the preemption issues which had been raised in this case.

REASONS FOR GRANTING THE PETITION

This Court Should Address The Important Questions Of Whether, And In What Circumstances, The Federal Courts Should Abstain From Adjudicating Allegations That A State Has Contravened A Preemptive Federal Statutory Scheme.

Because fundamental questions of federalism are raised whenever the federal courts are asked to refrain from exercising their jurisdiction, this Court's recent decisions have sought to develop the rules governing the application of the abstention doctrine on a cautious, case-by-case basis.[8] This case, together with the case of *Brown v. Hotel & Res. Emp. & Bar. Int. Union 54*, Case Nos. 83-498 and 83-573, in which this Court noted probable jurisdiction on November 28, 1983, presents the Court with an opportunity to address the important questions of whether, and in what circumstances, the abstention doctrine can be invoked to bar claims based on federal statutory preemption. The Fourth Circuit's decision, which conflicts both with the Third Circuit's decision in the *Brown* case and with recent decisions of the Second and Ninth Circuits, is an unprecedented expansion of the abstention doctrine to encompass a whole category of cases to which that doctrine had not previously been applied, and the decision below is

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8 For example, in *Moore v. Sims*, 442 U.S. 415, 423 n.8 (1979), the Court was careful to point out that "we do not remotely suggest that every pending proceeding between a state and a federal plaintiff justifies abstention unless one of the exceptions to *Younger* applies." Similarly, the Court has expressly reserved decision on the question of whether *Younger* abstention may be applied when, as in this case, a pending state proceeding is before a state administrative agency rather than a state court. *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 112 (1981).

therefore one of great significance which should be reviewed by this Court.

Point I.

This Court Should Consider The Important Question, Which Has Divided The Circuit Courts, Of Whether Abstention Is Ever Appropriate When A Federal Plaintiff Alleges That A State Agency Has Violated A Preemptive Federal Statutory Scheme.

The Court of Appeals rejected petitioners' argument that abstention is never appropriate when a plaintiff asserts claims based on federal statutory preemption. The Court of Appeals decided this important issue erroneously, because it failed to undertake any meaningful analysis of whether the purposes of the abstention doctrine, and the considerations of comity and federalism on which that doctrine is based, would be served by relegating federal preemption claims to the state courts.

A. *The Considerations Of Comity And Federalism Which Are The Basis For The Abstention Doctrine Are Never Served By Dismissing Federal Preemption Claims.*

As this Court recognized in *Colorado River Conservation District v. United States*, 424 U.S. 800, 813-17 (1976), there are three variants of the abstention doctrine, which are generally known as *Pullman*, *Burford*, and *Younger* abstention. *Railroad Comm'n v. Pullman Co.*, 312 U.S. 496 (1941); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943); *Younger v. Harris*, 401 U.S. 37 (1971). Although these three forms of abstention had their origins in three separate decisions of this Court, in application they frequently overlap and, in particular, the *Burford* and *Younger* doctrines on which the lower courts relied in this case are very similar in substance.[9]

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9 Both the *Burford* and *Younger* doctrines are basically concerned with preventing unnecessary federal interference with state proceedings involving matters which are of strong, legitimate interest to the state. The two doctrines evolved separately because the *Younger* doctrine originally

At bottom, the abstention doctrine in all of its forms is founded on considerations of federalism and comity. *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 606 (1975). The doctrine counsels that when a state is attempting to develop or enforce the state's policies concerning matters which, under the federal system, are properly of state rather than federal concern, the federal courts should not, absent exigent circumstances, interfere in the state proceedings. For example, this Court has characterized the *Burford* doctrine, on which the Court of Appeals principally relied below, as appropriate only in cases "where there have been presented difficult questions of *state* law bearing on policy problems of substantial public import whose importance transcends the result in the case at bar" and where "federal review of the [state law] question . . . would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Colorado*

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focused on the circumstances in which a federal court could properly intervene in pending state *criminal* proceedings, while the *Burford* doctrine dealt with other forms of state regulatory activity. In recent cases, however, the Court has blurred the distinction between the two doctrines by holding that *Younger* abstention may be appropriate when the state is a party to "civil proceedings in which important state interests are involved." *Moore v. Sims*, 442 U.S. 415, 423 (1979). To the extent that *Younger* abstention applies to state proceedings which are civil rather than criminal in nature, it creates a substantive standard for abstention which would appear to be virtually identical to the *Burford* test.

Pullman abstention, the third recognized variant of the abstention doctrine, is somewhat different from *Burford* and *Younger* abstention, and has no relevance here. Under *Pullman*, a federal court may abstain from deciding a *constitutional* challenge to an *ambiguous* state statute if a narrow construction of the statute by the state courts would cure the alleged constitutional deficiency. *Pullman* abstention is thus based not only on the considerations of comity and federalism that underlie the *Burford* and *Younger* doctrines, but also on the more general notion that constitutional adjudications should be avoided if a more limited ground for decision may be available. *Harmon v. Forssenius*, 380 U.S. 528, 534 (1965). The *Pullman* doctrine cannot be invoked to support the lower courts' decisions in this case because, under *Pullman*, the federal court may not dismiss the federal case, as the lower courts did here, but must instead retain jurisdiction until the parties have repaired to the state courts for an interpretation of the relevant state law. *England v. Bd. of Medical Examiners*, 375 U.S. 411 (1964).

River Conservation District v. United States, *supra*, 424 U.S. at 814 (emphasis supplied). Similarly, this Court's decisions applying the more recent *Younger* variant of the abstention doctrine have "imposed a requirement that the State must show that it has an important interest to vindicate in its own courts before the federal court must refrain from exercising otherwise proper federal jurisdiction." *Trainor v. Hernandez*, 431 U.S. 434, 448 (1977) (Blackmun, J., concurring). *Accord, Moore v. Sims*, 442 U.S. 415, 423 (1979).

These notions of comity and federalism, which lead the federal courts to defer to state institutions when the state is addressing subjects which the state is constitutionally free to regulate, have no relevance to preemption cases. Allegations that a state agency has attempted to circumvent a preemptive federal regulatory scheme charge that it is the state, rather than the federal court or the federal plaintiff, which has disregarded the constitutional allocation of power between the state and federal governments. As the Court of Appeals for the Ninth Circuit has observed:

> A preemption claim alleges in essence that Congress has determined that particular matters are of national concern and should be administered by national, rather than local institutions. If a preemption claim is well-founded, therefore, *Burford* abstention *cannot* be appropriate.

I.B.E.W. v. P.S.C., 614 F.2d 206, 212, n.1 (9th Cir. 1980) (emphasis supplied). *Accord, Knudsen Corp. v. Nevada State Dairy Comm.*, 676 F.2d 374, 377 (9th Cir. 1982).

Similarly, in the *Brown* case in which this Court recently noted probable jurisdiction, the Third Circuit held that *Burford* abstention "has no application" to a complaint alleging federal preemption, for the following reason:

> [N]o argument can be entertained based on disruption of a state administrative scheme in a case in which the court is asked to decide whether the very existence of that scheme violates a paramount federal statute.

Hotel & Res. Emp. & Bar. Int. Union 54 v. Danziger, 709 F.2d 815, 832 (3rd Circuit), *probable jurisdiction noted, sub nom.*

Brown v Hotel & Res., etc., ____ U.S. ____ (Case Nos. 83-498 and 83-573, Nov. 28, 1983). The Third Circuit further held in that case that *Younger* abstention was not appropriate because:

> [W]hen the issue tendered to a federal district court is the very power [of the state tribunal], as a matter of federal law, to entertain a threatened proceeding, the principles of comity and federalism which apparently animate the *Younger* v. *Harris* rule are totally inapplicable.

709 F.2d at 833.

The application of the abstention doctrine requires "sensitivity to the legitimate interests of both State and National Governments . . .," *Younger v. Harris, supra*, 401 U.S. at 44, and thus depends on a "balancing [of] the federal and state interests. . ." *Trainor v. Hernandez, supra*, 431 U.S. at 448 (Blackmun, J., concurring). When a federal plaintiff alleges that a state agency has contravened a preemptive federal regulatory scheme this balancing process must result in the retention of jurisdiction by the District Court, because the federal government has an obvious interest in protecting the integrity of the federal regulatory process, while the state has no legitimate interest in enforcing state regulations which have been preempted by federal statute. *Baggett v. Dept. of Professional Regulation*, 717 F.2d 521, 523-4 (11th Cir. 1983). In these circumstances, invocation of the abstention doctrine is "inconsistent with [the federal courts'] paramount duty to interpret and protect federal policies . . ." *Kennecott Corp. v. Smith*, 637 F.2d 181, 187 (3rd Cir. 1980).

B. *The Fact That Federal Law Provides The Rule Of Decision In Preemption Cases Is A Further Reason Why Abstention Is Not Appropriate.*

One of the considerations of comity and federalism which the abstention doctrine addresses is the concern that a federal court's failure to defer to a state court might create an impression in the public mind that the state courts were not competent to rule on questions of state law, or on fundamental constitutional questions that form the common foundation of

the federal and state judicial systems. Thus, this Court has recognized that a refusal to abstain in a case involving *constitutional* issues "can readily be interpreted as reflecting negatively upon the state court's ability to enforce constitutional principles." *Huffman v. Pursue, Ltd.*, *supra*, 420 U.S. at 604, *quoting from Steffel v. Thompson*, 415 U.S. 452, 462 (1974). Similarly, the Court's decision in the *Colorado River Conservation District* case, quoted at p. 11, *supra*, recognized that the *Burford* doctrine is intended principally to avoid federal adjudication of important questions of *state* law in cases in which, for example, the federal court's jurisdiction is invoked on the basis of diversity of citizenship.[10]

These concerns have no relevance when a federal plaintiff alleges that a federal statute has preempted state jurisdiction. Resolution of the preemption claim turns entirely on the construction and application of the federal statute, and, as this Court has observed, "the federal courts are particularly appropriate bodies for the application of preemption principles." *United Mine Workers v. Gibbs*, 383 U.S. 715, 729 (1966). *Accord, Hagans v. Lavine*, 415 U.S. 528, 548, 550 (1974). *See, also, Northern State Gas Co. v. S.C.C. of Kansas*, 372 U.S. 84, 96-98 (1963). The exercise of federal jurisdiction in a preemption case does not cast an invidious inference as to the competence of the state courts to adjudicate constitutional or state-law issues, but simply recognizes that the federal courts have superior expertise in the construction and application of federal statutes, just as the state courts are, as the federal courts concede, the definitive authorities on questions of state law. *See, e.g. O'Brien v. Skinner*, 414 U.S. 524, 531 (1974).

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10 The Court of Appeals decision below incorrectly interpreted the *Burford* doctrine when it invoked *Burford* to justify its decision to abstain from adjudicating petitioners' claims, which required the application of *federal*, rather than *state*, law.

C. *The History And Evolution Of The Abstention Doctrine Demonstrate That The Doctrine Was Not Intended To Bar Adjudication of Claims Based On Federal Statutory Preemption.*

The abstention doctrine is in large measure a response to this Court's decision in *Ex Parte Young*, 209 U.S. 123 (1908), which the Court has characterized as "the watershed case which sanctioned the use of the Fourteenth Amendment to the United States Constitution as a sword as well as a shield against unconstitutional conduct of state officers." *Juidice v. Vail*, 430 U.S. 327, 335 (1977). In *Ex Parte Young*, the Court held that the sovereign immunity guaranteed to the states by the Eleventh Amendment did not prevent the federal courts from entertaining suits to enjoin state officials from enforcing state regulations which were contrary to the federal constitution.

Ex Parte Young created a mechanism by which federal courts could vindicate the supremacy of federal law, but it also had the undesirable effect of opening the federal courts to plaintiffs who sought to raise broad-ranging challenges, generally on substantive due process grounds, to state regulatory statutes. *See Swift & Co. v. Wickham*, 382 U.S. 111, 116-119, 127 (1965). To restore the balance between the state and federal jurisdictions, Congress enacted legislation which restricted the federal courts' ability to hear these challenges. The statutes which, in essence, legislatively created the abstention doctrine included former 28 U.S.C. § 2281, which required that constitutional challenges to state statutes be heard by special three-judge courts, and the Johnson Act of 1934, 28 U.S.C. § 1342, which prevented the federal courts from enjoining the enforcement of state ratemaking orders if certain specified conditions were satisfied.

What is significant about these "abstention" statutes is that they did not overrule *Ex Parte Young* or withdraw all federal jurisdiction over challenges to state laws and regulations. Rather, the statutes struck a balance which, in each instance, left the federal court's jurisdiction over federal statutory preemption claims unaffected by the legislation. Thus, as this

Court held in *Swift & Co. v. Wickham*, *supra*, former 28 U.S.C. § 2281 was not intended by Congress to require a three-judge court in preemption cases, for the following reason:

> [Congress'] ire was aroused by the frequent grants of injunctions against the enforcement of progressive state regulatory legislation, usually on substantive due process grounds. Requiring the collective judgment of three judges and accelerating appeals to this Court were designed to safeguard important state interests. In contrast, a case involving an alleged incompatibility between state and federal statutes, such as the case before us, involves more confining legal analysis and can hardly be thought to raise the worrisome possibilities that economic or political predilections will find their way into a judgment.

382 U.S. at 127.

Similarly, this Court held relatively early in the history of the Johnson Act that the Act did not prevent federal courts from enjoining state ratemaking orders which were challenged on preemption grounds. By its terms, the Johnson Act may be invoked only if the state order "does not interfere with interstate commerce." 28 U.S.C. § 1342(2). In *P.U.C. v. United Fuel Gas Co.*, 317 U.S. 456, 469-70 (1943), the Court ruled that orders of state commissions " 'interfere with interstate commerce' to the extent that they constitute an attempt to regulate matters in interstate commerce which Congress has lodged exclusively with the Federal Power Commission."

This Court's adoption of the *Burford* abstention doctrine was largely an effort to fill the interstices left by legislation, by requiring abstention, as a matter of judicial discretion, in cases in which the policies underlying the Johnson Act favor abstention, but the Act is not directly applicable by its terms because the challenged state law or regulation does not concern ratemaking. *See Alabama P.S.C. v. Southern R. Co.*, 341 U.S. 341, 350-51 (1951). Just as it did in construing the "abstention" statutes, the Court held that the *Burford* doctrine does not require the federal courts to abstain from deciding preemption cases:

> Federal courts seek to avoid needless conflict with state agencies and withhold relief by way of injunction where state remedies are available and adequate. But where Congress, acting within its constitutional authority, has vested a federal agency with exclusive jurisdiction over the subject matter and the intrusion of a state would result in conflict of function, the federal court may enjoin the state proceeding in order to preserve the federal right.

Capital Service, Inc. v. N.L.R.B., 347 U.S. 501, 504 (1954) (citations omitted).[11]

In recent years, the Court's consideration of abstention issues has occurred primarily in the context of the *Younger* line of cases. For the most part, these cases, like the earlier cases which led to the legislation discussed above and the *Burford* doctrine, have involved broad, fundamental challenges to state regulatory schemes (although these challenges have generally relied on procedural due process grounds rather than on the substantive due process arguments raised in the earlier cases). This Court has not yet ruled on the question of whether the *Younger* doctrine may be invoked to bar claims based on preemption, although it may have occasion to do so in the pending *Brown* case if it resolves other issues against the appellants.[12] However, as discussed above, the *Younger* doctrine is based on the same considerations of federalism and comity, and requires the same balancing of state and federal interests, as the other abstention doctrines. The Courts of

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11 In so holding, the Court distinguished *Alabama P.S.C. v. Southern R. Co.*, *supra*, which had applied the *Burford* doctrine, and relied upon *P.U.C. v. United Fuel Gas Co.*, *supra*.

12 The principal issue raised by the jurisdictional statements in *Brown* is whether, on the merits, federal law has preempted the challenged state regulation. If the Court rules for the appellants on this issue, the abstention issue will be moot. By contrast, the Fourth Circuit's decision in this case squarely presents the issue of whether abstention is appropriate in preemption cases, because the lower court assumed for purposes of affirming the dismissal of petitioners' preemption claims that those claims were valid but could not be proved without factfinding.

Appeals which have considered the question (other than the Fourth Circuit in this case) have therefore held that the *Younger* doctrine, like the other forms of abstention, has no applicability in preemption cases. *Hotel & Res. Emp. & Bar Int. Union 54 v. Danziger, supra; Stone & Webster Engineering Corp. v. Ilslely,* 690 F.2d 323, 326 n. 2 (2nd Cir. 1982), *aff'd,* 103 S.Ct. 3564 (1983).

A review of the development of abstention principles in the seventy five years since *Ex Parte Young* thus demonstrates that claims of federal statutory preemption stand on a special footing, and do not present appropriate occasions for the federal courts to abstain from exercising their jurisdiction. This inapplicability of the abstention doctrine to preemption cases is explained in part by the overriding federal interest in protecting the integrity of a preemptive federal statutory scheme. On the other side of the balance, federal adjudication of claims based on federal statutory preemption involve "a more confining legal analysis" than broad due-process challenges, *Swift & Co. v. Wickham, supra,* 382 U.S. at 127, and the important federal interests which preemption cases raise can be vindicated without disrupting the basic statutory and procedural framework which the state has adopted to regulate matters properly within its jurisdiction.[13] The fundamental concerns underlying the evolution of the abstention doctrine therefore have no application, and the Court of Appeals erred when it extended that doctrine to preemption cases.

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13 For example, the injunctive relief which Alcoa and Tapoco seek here would not invalidate the NCUC's basic procedures or leave the NCUC procedurally incapable of regulating local utility rates, but would only require the NCUC to accept, for its own ratemaking purposes, the way in which the superior federal authorities have regulated Nantahala's power supply arrangements. By contrast, the relief sought on due process grounds in many of the *Younger* line of cases would have invalidated basic procedures which the state had adopted to implement and enforce its policies, leaving the state no lawful way of performing important functions which are the responsibility of the local, rather than the federal, government.

D. *The Court Should Resolve The Conflict Between The Circuits As To Whether The Federal Courts Should Abstain In Preemption Cases.*

For the reasons discussed above, the question of whether the federal courts should abstain from adjudicating claims based on federal statutory preemption is an important one which should be addressed by this Court. The Court should also hear this case to resolve the conflict between the Fourth Circuit's resolution of this issue, and the contrary holdings of other circuits. Within the past two years, the Second Circuit, the Third Circuit and the Ninth Circuit have squarely rejected the argument, accepted by the Fourth Circuit in this case, that abstention can properly be invoked to dismiss preemption claims. *Knudsen Corp. v. Nevada State Dairy Comm.*, *supra*, 676 F.2d at 377; *Stone & Webster Engineering Corp. v. Ilslely*, *supra*, 690 F.2d at 320, n.2; *Hotel & Res. Emp. & Bar. Int. Union 54 v. Danziger*, *supra*, 709 F.2d at 832. Although the Court has noted probable jurisdiction in the pending *Brown* case to review the Third Circuit's decision in the last cited case, it is quite possible that the Court will decide that appeal on other grounds without reaching the abstention issue, see p. 17, n.12, above, and it is therefore appropriate that the Court grant this petition to assure the resolution of the conflict between the circuits on this important question of federalism.[14]

The conflict between the Fourth Circuit's decision and prior authority is even broader than the citation of recent circuit

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14 While the three circuits identified above have adopted a categorical rule, contrary to the Fourth Circuit's decision here, that abstention is never appropriate in preemption cases, the Eleventh Circuit, in a recent decision holding that absention was inappropriate in the particular preemption case then before it, stated in *dicta* that "[i]t would be an overstatement to suggest that when the question is one of preemption, abstention . . . is never appropriate." *Baggett v. Dept. of Professional Regulation*, 717 F.2d 521, 524 (11th Cir. 1983). However, unlike the Fourth Circuit in this case, the Eleventh Circuit recognized that the appropriateness of abstention in a preemption case turns on a balancing of state and federal interests, rather than on the question of whether factfinding is necessary to adjudicate the federal preemption claims. See p. 22, n.17, *infra*.

court decisions suggests. At least since this Court decided the *Capital Service* case, *supra*, in 1954, it seems to have been generally accepted that abstention is not appropriate in preemption cases, and many courts have entertained preemption challenges to state regulations or orders with little or no discussion of the abstention issue. For example, in *Stone & Webster Engineering Corp. v. Ilslely, supra*, 690 F.2d at 326, n.2, the Second Circuit rejected the argument that the federal courts should abstain in a footnote, which stated without analysis that abstention "is not appropriately invoked in a preemption case."[15] Similarly, this Court recently held in *Edgar v. MITE Corp.* 457 U.S. 624 (1982), that a state corporate-takeover statute violated the Commerce Clause, and the Court ruled in *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977), that a state weights-and-measures statute had been preempted by federal law, even though, in both of these cases, state enforcement proceedings were pending at the time the federal litigation was commenced and, on the Fourth Circuit's theory, abstention would have been appropriate.

In summary, the decision of the Court of Appeals in this case results in an important change in the established law of this Court and other circuits which will significantly alter the relationship between the federal courts and the states, and that decision should be reviewed by this Court.

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15 The Second Circuit had previously held in *Chemical Specialties Mfrs. Ass'n v. Lowery*, 452 F.2d 431 (2d Cir. 1971), that the abstention doctrine was not applicable in a preemption case.

Point II.

Assuming That Abstention May In Some Circumstances Be Proper In A Preemption Case, This Court Should Decide The Important Issue Of Whether The Court Of Appeals Established The Correct Legal Standard For Determining When Abstention Is Appropriate.

For the reasons discussed above, petitioners urge this Court to adopt a clear-cut rule that abstention is never appropriate when a plaintiff raises claims based on federal statutory preemption. Assuming that the Court is not prepared to adopt this categorical rule, it should nonetheless review this case to consider the equally important issue, which is not raised by the *Brown* case already before the Court, of when, and in what circumstances, the abstention doctrine may properly be invoked to bar preemption claims.[16]

The Court of Appeals' decision below purported to recognize that "[t]he presence of a preemption claim . . . may in some cases require a refusal to abstain." (12a). The lower court, however, believed that in this case "evaluation of the preemption claim would involve detailed factfinding . . ." and held that "the federal court need not engage in such factfinding as a prerequisite to abstention." *Id.*

The Court of Appeals' approach to the abstention issue is novel and entirely unprecedented. As demonstrated above, all prior decisions applying the abstention doctrine had turned on the relative interests which the state and federal governments had in the resolution of the underlying substantive controversy. The Court of Appeals' decision simply ignores the balancing of state and federal interests which had previously been consid-

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16 Review of the Fourth Circuit's decision in this case would be particularly important if the Court reaches the abstention issue in *Brown* and rejects the Third Circuit's *per se* rule against abstention in preemption cases. This case would then provide a vehicle through which the Court might provide guidance to the lower courts as to the factors they must weigh and consider in determining which preemption cases are appropriate candidates for abstention.

ered necessary to determine whether abstention is appropriate and holds that a federal court may abstain solely because the resolution of plaintiffs' federal claims would require the court to adjudicate a factual controversy.[17]

The Court of Appeals' decision is also contrary to the general federal rule that in deciding a motion to dismiss, a court must accept the well pleaded allegations of the complaint as true. *See, e.g., Lemon v. Kurtzman*, 403 U.S. 602, 620, 669 (1971). Furthermore, the rule adopted by the Court of Appeals in this case would allow state officials who have allegedly ignored preemptive federal regulatory provisions to prevent the exercise of federal jurisdiction by the simple expedient of denying the allegations of the complaint, and the decision below thus greatly expands the applicability of the abstention doctrine.

The Court of Appeals sought to bolster its holding that abstention was appropriate by observing that, after the District Court dismissed their complaint, Alcoa and Tapoco attempted to raise their federal claims on appeal from the NCUC's orders to the North Carolina courts. However, while the availability of a potential remedy in the state courts is a *necessary* prereq-

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17 As indicated above, the Eleventh Circuit's decision in the *Baggett* case, *supra*, which declined to adopt a *per se* rule against invoking the abstention doctrine in preemption cases, recognized that the determination of whether abstention was appropriate in such a case required a balancing of the substantive interests of the state and federal governments in the controversy, and the court's analysis did not take into account the factor, which the Fourth Circuit found determinative, of whether the federal court would need to adjudicate facts to resolve the federal claims. 717 F.2d at 523-24. Thus, even with respect to the two circuits which recognize the possibility that the abstention doctrine may be invoked in some preemption cases, there is a conflict as to the test which should be applied to decide when abstention is appropriate.

The Fourth Circuit's decision in this case is also contrary to the decision of the Second Circuit in *Chemical Specialties Mfrs. Ass'n v. Lowery*, 452 F.2d 431, 440 (2d Cir. 1971), in which the Second Circuit rejected the argument that the federal courts should abstain in favor of further factfinding proceedings in the state courts, and remanded the case to the District Court for "an orderly factual investigation by a federal court of the relationship between the [local regulations] and the relevant federal laws."

uisite to abstention, it has never been held to be a *sufficient* ground in itself to justify the relinquishing of federal jurisdiction over federal claims. *See Middlesex County Ethics Committee v. Garden State Bar Ass'n, supra.* In literally every case, the federal plaintiff will, if his claims are dismissed, have the option of presenting his federal issues to a state court and, ultimately, seeking review in this Court. However, as this Court firmly held in *Colorado River Conservation District v. United States, supra,* and *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp., supra,* the pendency of a "parallel" state court proceeding is not sufficient reason for dismissing a federal action unless (1) one of the traditional abstention doctrines is applicable or (2) "exceptional circumstances" exist which require dismissal.

In this case, the Court of Appeals relied entirely on its erroneous holding that *Burford* abstention barred petitioners' preemption claims, and the lower court neither discussed nor purported to apply the alternative "exceptional circumstances" test of the *Colorado River* case. Further, the Court of Appeals' determination that the federal courts could not adjudicate petitioners' preemption claims without factfinding does not constitute "exceptional circumstances" justifying dismissal under the *Colorado River* standard, which is "considerably more limited" than the abstention doctrine. 424 U.S. at 818.

Like the abstention doctrine, the application of the "exceptional circumstances" test requires "a careful balancing of the important factors as they apply in a given case, with the balance heavily weighted in favor of the exercise of jurisdiction." *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp., supra,* 103 S.Ct. at 937. The "most important factor" which demonstrated that "exceptional circumstances" were present in *Colorado River* itself was Congress' enactment of legislation specifically authorizing suits against the United States in the state courts, which "represents Congress's judgment that the field of water rights is one peculiarly appropriate for comprehensive treatment in the [state] forums having the greatest experience and expertise, assisted by state administrative officers acting under the state courts." *Moses H. Cone Mem.*

Hosp. v. Mercury Const. Corp., *supra*, 103 S.Ct. at 937. By contrast, "[a] preemption claim alleges in essence that Congress has determined that particular matters are of national concern and should be administered by national, rather than local institutions," *I.B.E.W. v. P.S.C.*, *supra*, 614 F.2d at 212, n.1, so this key prerequisite to the application of the "exceptional circumstances" test is absent in a preemption case such as this.

A second major factor in applying the "exceptional circumstance" test, which the Court of Appeals' analysis did not consider, is the question of whether "federal law provides the rule of decision on the merits." *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, *supra*, 103 S.Ct. at 941. The resolution of the federal issues raised by petitioners in this case turns on whether the Federal Power Act has preempted the NCUC's regulatory jurisdiction over Nantahala's power supply arrangements, and "the presence of [such] federal-law issues must always be a major consideration weighing against surrender [of federal jurisdiction]." *Id.* at 942 (footnote omitted).[18]

In short, the result which the Court of Appeals reached in this case cannot be justified under the "exceptional circumstances" test, which the Court of Appeals simply ignored, nor

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18 If the Court of Appeals had attempted to apply the "exceptional circumstances" balancing test, it would have been required to consider, in addition to the two major factors identified above, (1) the relative geographic convenience of the state and federal courts, (2) the order in which the two courts achieved jurisdiction over the controversy, and (3) the possibility of avoiding "piecemeal" litigation. Of these subsidiary factors, the first two clearly do not favor dismissal, since (1) the state appellate courts and the District Court are both located in Raleigh, North Carolina, and (2) the petitioners brought their federal suit against the NCUC before the state court appeals were commenced, and raised their federal issues in the state courts only after the District Court dismissed their complaint. The third factor, the desirability of avoiding duplicative adjudication, is not sufficient in itself to justify relinquishing federal jurisdiction, *see Colorado River Conservation District v. United States*, *supra*, and, in any event, is of little or no force here because the issues of federal law which petitioners seek to raise are "easily severable" from the state-law ratemaking issues which the state appellate courts will address. *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, *supra*, 103 S.Ct. at 939.

under the alternative balancing test of the abstention doctrine, which the lower court misapplied. The Court of Appeals' decision to relegate petitioners' federal preemption claims to the state courts to avoid the need for factfinding in the federal courts adopts a standard for relinquishing federal jurisdiction which is considerably easier for a defendant to satisfy than any test which this Court has ever approved under either the abstention doctrine or the "exceptional circumstance" line of cases. Because the standard applied by the Court of Appeals would effectively destroy the careful balance which both of these lines of cases have drawn between competing state and federal interests, and because the Court of Appeals' decision is inconsistent with the basic rule that in the absence of an adequate reason for relinquishing jurisdiction, the federal courts have "the virtually unflagging obligation . . . to exercise the jurisdiction given them . . ." *Colorado River Conservation District v. United States*, *supra*, 424 U.S. at 817, the Court should grant this petition to consider whether the Court of Appeals adopted an appropriate test for determining when abstention is appropriate in preemption cases.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 16, 1983

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 82-1733(L)

Aluminum Company of America, a Pennsylvania Corporation, and Tapoco, Inc., a Tennessee Corporation,

Appellants,

v.

Utilities Commission of the State of North Carolina; Robert K. Koger, Leigh M. Hammond, Sarah Lindsay Tate, John W. Winter, Edward B. Hipp, A. Hartwell Campbell, and Douglas O. Leary, in their respective official capacities as Chairman and Commissioners of the North Carolina Utilities Commission,

Appellees,

Rufus L. Edmisten, Attorney General of North Carolina,

Amicus Curiae,

United Steelworkers of America, AFL-CIO, and Local Union 309,

Amicus Curiae.

No. 82-1765

State of Tennessee, Tennessee Office of Economic and Community Development,

Appellants,

and

Aluminum Company of America, a Pennsylvania Corporation, and Tapoco, Inc., a Tennessee Corporation,

Plaintiffs,

v.

Utilities Commission of State of North Carolina, Robert L. Koger, Leigh M. Hammond, Sarah Lindsay Tate, John W. Winter, Edward B. Hipp, A. Hartwell Campbell and Douglas O. Leary, in their respective official capacities as Chairman and Commissioners of the North Carolina Utilities Commission,

Appellees,

Rufus L. Edmisten, Attorney General of North Carolina,

Amicus Curiae,

United Steelworkers of America, AFL-CIO, and Local Union 309,

Amicus Curiae.

Appeals from the United States District Court for the Eastern District of North Carolina at Raleigh. Franklin T. Dupree, Jr., District Judge.

Before

MURNAGHAN and ERVIN, Circuit Judges, and KELLAM, District Judge.*

* Honorable Richard B. Kellam, Senior United States District Judge for the Eastern District of Virginia, sitting by designation.

Argued: April 11, 1983 Decided: July 28, 1983

Grant S. Lewis (Ronald D. Jones, David R. Poe, John S. Kinzey, LeBoeuf, Lamb, Leiby & MacRae on brief); Charles L. Lewis, Assistant Attorney General (William M. Leech, Jr., Attorney General, William B. Hubbard, Chief Deputy Attorney General; I. Edward Johnson, LeBoeuf, Lamb, Leiby & MacRae; Richard L. Holz, Assistant General Counsel on brief) for Appellants; Jerry W. Amos and Reid L. Phillips (Brooks, Pierce, McLendon, Humphrey & Leonard on brief) for Appellees; (Cooper, Mitch & Crawford; Jonathan R. Harkavy, Smith, Patterson, Follin, Curtis, James & Harkavy; Carl B. Frankel, United Steelworkers of America, AFL-CIO on brief) as Amicus Curiae United Steelworkers of America, AFL-CIO; (William T. Crisp, Robert F. Page, Crisp, Davis, Schwentker & Page; Rufus L. Edmisten, Attorney General, Richard L. Griffin, Assistant Attorney General on brief) as Amicus Curiae Rufus L. Edmisten.

ERVIN, Circuit Judge:

The Aluminum Company of America ("Alcoa") and its wholly owned subsidiary, Tapoco, Inc. ("Tapoco") appeal from the United States District Court for the Eastern District of North Carolina wherein their action against the Utilities Commission of the State of North Carolina ("NCUC") was dismissed on abstention grounds. Alcoa and Tapoco brought this action seeking to enjoin the enforcement of an NCUC order which allegedly interferes with the operation of a preemptive federal regulatory scheme and impermissibly burdens interstate commerce. Because we conclude that abstention was

appropriate under *Burford v. Sun Oil Company*, 319 U.S. 315 (1943), we affirm.[1]

I.

Alcoa operates a large aluminum smelting plant in eastern Tennessee and wholly owns two nearby electric utility companies, Tapoco and Nantahala Power and Light Company ("Nantahala"). Nantahala is incorporated in North Carolina and owns 11 hydroelectric plants in that state. Nantahala provides retail electric service in six counties in western North Carolina. NCUC regulates Nantahala's retail rates. Tapoco is a Tennessee corporation which owns four hydroelectric power plants, two in North Carolina and two in Tennessee. Tapoco provides electricity exclusively to Alcoa's smelting plant, which requires an enormous amount of energy.

The Tapoco and Nantahala dams are on streams which are a part of the larger Tennessee River watershed which has been developed for hydroelectric power production by the Tennessee Valley Authority ("TVA"). In 1941, Alcoa and TVA entered into an agreement, the "Fontana Agreement," whereby TVA was given the right to operate Tapoco's and Nantahala's dams. The agreement provided that the electricity generated at those dams would be transferred to TVA and that TVA would transfer back to Alcoa an equal amount of electricity at specified times and amounts. This agreement was superseded

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1 Our decision on the abstention issue—to affirm the dismissal—effectively moots the other appeal now before us, that of the United Steel Workers of America, the collective bargaining union for some 3,500 employees at Alcoa's Tennessee plant, and the State of Tennessee Office of Economic and Community Development. Those parties appeal the district court's denial of their motion to intervene under Fed. R. Civ. Proc. 24. We nevertheless note that our review indicates that the interests of the existing plaintiffs and the movants coincide and that the plaintiffs adequately have represented those interests. Thus, the district court did not abuse its discretion in denying the motion to intervene. *See Commonwealth of Virginia v. Westinghouse Electric Corp.*, 542 F.2d 214 (4th Cir. 1976) (intervention by Virginia denied in suit brought by utility against supplier of nuclear fuel).

in 1963 by the "New Fontana Agreement," effective through December 31, 1982, under which TVA continued to operate the dams, but returned to Alcoa a fixed entitlement of electricity regardless of the amount generated at the Alcoa dams. A supplemental agreement between Alcoa, Nantahala, and Tapoco apportioned the TVA fixed entitlement between Tapoco and Nantahala. Under that supplemental agreement, Nantahala received electricity at the favorable entitlement prices in an amount equal to the greater of Nantahala's actual production or the theoretical minimum production of the Nantahala system. If Nantahala needed more electricity than its TVA entitlement, Nantahala had to purchase that additional electricity from the TVA at a price substantially higher than the entitlement price.

In 1971, Nantahala and Tapoco entered into a new apportionment agreement, reducing Nantahala's TVA entitlement to an amount equal to Nantahala's theoretical minimum potential generation, regardless of actual production. The remainder of the entitlement goes to Tapoco for transfer to Alcoa's plant. Thus, under the 1971 agreement, Nantahala received less electricity from TVA at the lower entitlement price, increasing the cost to Nantahala's North Carolina retail customers, and Tapoco received more electricity from TVA at the lower entitlement price, decreasing the cost to Alcoa's plant.

In 1976, Nantahala applied to the NCUC for an increase in the rates it charges its retail customers. The NCUC permitted certain ratepayers along with the North Carolina Attorney General to intervene in the proceedings. The intervenors contended that the relationships between Nantahala, Tapoco, and Alcoa were unfair to Nantahala and its customers. In order to rectify the inequity, the intervenors recommended that the NCUC apply the "roll-in" method of rate making, that is, the NCUC should consider Tapoco and Nantahala as a single system for purposes of calculating Nantahala's rate base. The NCUC rejected the intervenors' contention of unfairness and did not consider the roll-in method.

On appeal by the intervenors, the North Carolina Court of Appeals and the North Carolina Supreme Court agreed with

the intervenors and directed the NCUC to consider using a roll-in method. *See Utilities Comm'n v. Edmisten*, 252 S.E.2d 516 (N.C. Ct.App.), *aff'd*, 263 S.E.2d 583 (N.C. 1980).

On remand, Alcoa and Tapoco were made parties to the proceedings, the NCUC heard additional evidence, and adopted the roll-in method. In so doing, the NCUC found that Nantahala and Tapoco constituted a single system, calculated the fair value of the entire system, and determined what portion of that total system is devoted to North Carolina intrastate retail service. Rates were based on the cost of service calculated from that apportionment. On September 2, 1981, the NCUC entered an order reducing Nantahala's rates and requiring Nantahala to pay $18,962,000 in refunds to its customers for the earlier years' overpayments. The NCUC joined Alcoa and Tapoco to the refund order because the NCUC concluded that "Nantahala is financially unable to make all the refunds required."

Nantahala, Tapoco, and Alcoa petitioned the NCUC to reconsider its September 2 order. On January 28, 1981, the NCUC issued an affirmance of the September 2 order. The NCUC orders then were appealed to the North Carolina Court of Appeals. Nantahala, Alcoa, and Tapoco have submitted their appellate briefs to that court, raising therein, among other issues, the federal issues argued in this action.

Contemporaneously with the NCUC proceedings, the Federal Energy Regulatory Commission ("FERC") was holding proceedings on the New Fontana and 1971 apportionment agreements. Under the Federal Power Act, 16 U.S.C. §§ 791(a), *et seq.*, the FERC oversees the licensing of the Nantahala and Tapoco plants, their sale of electricity in interstate commerce, and their wholesale of electricity. In 1976, Nantahala applied to FERC for an increase in wholesale rates, and in response, two wholesale customers and the North Carolina Attorney General intervened, charging that Alcoa, Nantahala, and Tapoco "are in violation of the Federal Power Act by diverting for the benefit and private use of Alcoa, hydroelectric power and facilities." FERC declined to apply the roll-in method of rate making, but did find that "the

alleged fairness of the 1971 apportionment agreement is not supported by the record" and modified that agreement "to provide [TVA] entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers." Nantahala has appealed the FERC decision to this court. *Nantahala Power & Light Co. v. F.E.R.C.*, No. 82-1872.

On January 26, 1982, two days prior to the NCUC affirmance of its September 2 order, Alcoa and Tapoco filed this action in the United States District Court for the Eastern District of Tennessee. By order dated April 12, 1982, the action was transferred to the Eastern District of North Carolina. On July 29, 1982, the district court dismissed the action. The district court rejected NCUC's arguments for dismissal for lack of jurisdiction, but granted the dismissal on abstention grounds. This appeal followed.

II.

We are now confronted with two questions. First, did the district court possess jurisdiction? Second, if so, did the district court properly abstain from the exercise of that jurisdiction? We answer both questions in the affirmative.

A.

The NCUC puts forth three arguments in support of the claim that the district court lacked jurisdiction: (1) the Johnson Act, 28 U.S.C. § 1342, prohibits the district court's exercise of its injunctive power against the NCUC; (2) the action is barred by the eleventh amendment; and (3) the alleged federal questions are merely defenses to be raised in the pending state action and therefore cannot form the basis of federal question jurisdiction. Those arguments are without merit.

Under the Johnson Act, 28 U.S.C. § 1342, Congress placed statutory limitations on the circumstances in which a federal court could issue injunctions against state orders setting rates for public utilities. The Johnson Act provides:

> The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a rate-making body of a State political subdivision, where:
>
> (1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and
>
> (2) The order does not interfere with interstate commerce; and
>
> (3) The order has been made after reasonable notice and hearing; and
>
> (4) A plain, speedy and efficient remedy may be had in the court of such State.

The limitation applies only when all four conditions are met. Since the first two conditions are not satisfied here, the Johnson Act does not apply. Alcoa and Tapoco have based jurisdiction upon federal questions, preemption and impermissible interference with interstate commerce. Thus, jurisdiction is not based "solely on diversity. . . . or repugnance . . . to the federal constitution." *See Int'l Brotherhood of Elec. Workers v. Public Service Comm'n of Nevada*, 614 F.2d 206, 210-11 (9th Cir. 1980). Moreover, the allegation that the NCUC order impermissibly interferes with interstate commerce, if proven, would defeat the second condition of the Johnson Act.

The eleventh amendment provides that federal jurisdiction does not extend to a suit against a state by a citizen of another state. In *Ex Parte Young*, 209 U.S. 123 (1968), the Court held that the eleventh amendment did not prevent a suit to enjoin state officials from enforcing a state rate regulation found to be in violation of the federal constitution. That is precisely the type of injunctive relief that Alcoa and Tapoco seek. *See also Kimble v. Solomon*, 599 F.2d 599, 603 (4th Cir.), *cert. denied*, 444 U.S. 950 (1979).

Alleged federal questions that are, in fact, merely defenses to be raised in the pending state action cannot form the basis

of federal question jurisdiction. *Public Service Comm'n of Utah v. Wycoff*, 344 U.S. 237 (1952); *City National Bank v. Edmisten*, 681 F.2d 942 (4th Cir. 1982). In *City National Bank*, this court stated:

> The federal question must be an essential element of plaintiff's complaint; *the anticipation of a defense* which arises under federal law does not establish federal jurisdiction. Louisville & Nashville Rd. Co. v. Mottley, 211 U.S. 149, 29 S.Ct. 42, 53 L.Ed. 126 (1908). Accordingly, in an action for a declaratory judgment, *if the plaintiff is seeking a declaration that it has a good defense to a threatened action*, it is the character of the threatened action and not of the defense which determines whether there is federal question jurisdiction. See Public Service Commission v. Wycoff, 344 U.S. 237, 248, 73 S.Ct. 236, 242, 97 L.Ed. 291 (1952).

Id. at 945 (emphasis added). In that case, five banks sought a declaratory judgment that a credit card fee would not constitute interest under North Carolina law because such an interpretation of the state law would cause a conflict with the National Banking Act, 12 U.S.C. §§ 85, 86. The banks claimed that the North Carolina Attorney General had threatened to sue them if they charged the fee. This court ordered the action dismissed, holding that the threatened action would have to be brought, if at all, under North Carolina law and was not converted into a federal action simply by the availability of a federal defense.

The obvious distinction between *City National Bank* and the present case is that the latter is not a declaratory judgment action involving "the anticipation of a defense" or "a declaration that it has a good defense to a threatened action." Rather, plaintiffs seek to enjoin an already-issued NCUC order. The federal courts, of course, often entertain suits to enjoin the enforcement of state orders which are alleged to have been preempted by federal statutes or to burden unduly interstate commerce. *See, e.g., Public Utilities Commission of Ohio v. United Fuel Gas Company*, 317 U.S. 456 (1943); *Kennecott Corp. v. Smith*, 637 F.2d 181 (3d Cir. 1980).

B.

In *Burford v. Sun Oil Company*, 319 U.S. 315 (1943), the court held that abstention was proper in a challenge to a Texas state commission's oil field proration order. The Court reasoned:

> These questions of regulation of the industry by the State administrative agency . . . so clearly involve basic problems of Texas policy that equitable discretion should be exercised to give the Texas courts the first opportunity to consider them . . . . The state provides a unified method for the formation of policy and determination of cases by the Commission and by the state courts. The judicial review of the Commission's decision in the state courts is expeditious and adequate. Conflicts in the interpretation of state law, dangerous to the success of state policies, are almost certain to result from the intervention of the lower federal courts. On the other hand, if the state procedure is followed from the Commission to the State Supreme Court, ultimate review of the federal question is fully preserved here . . . . Under such circumstances, a sound respect for the independence of state action requires the federal equity court to stay its hand.

Id. at 332-34 (citations omitted). *See also Alabama Public Service Comm'n v. Southern R. Co.*, 341 U.S. 341, 349 (1951) (abstention required in challenge to state railroad commission order; "As adequate state court review of an administrative order based upon predominantly local factors is available to appellee, intervention of a federal court is not necessary for the protection of federal rights").

The NCUC order establishes retail, intrastate rates for North Carolina customers. The setting of those rates involved important and basic considerations of state policy and was accomplished in accordance with the uniform statutory procedures for the formation of that policy. *See* N.C.G.S. § 62-130, *et seq.*

The NCUC order now is on appeal[2] to the North Carolina Court of Appeals and Alcoa, Nantahala, and Tapoco have raised therein, along with certain state law issues,[3] the same federal issues that they are asking the federal courts to consider. We therefore believe that the present case involves the quintessential *Burford* setting of a complex state regulatory scheme concerning important matters of state policy for which impartial and fair administrative determinations subject to expeditious and adequate judicial review are afforded. The usual role of comity must govern; the district court properly exercised its discretionary power to withhold relief so as to avoid needless obstruction of North Carolina's domestic policy.

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2 Not only are state proceedings pending, but the challenged NCUC order was reached after a specific remand by the North Carolina Supreme Court. While we need not decide whether abstention is appropriate here under the "Our Federalism" doctrine, *see Younger v. Harris*, 401 U.S. 37 (1971); *see generally* C. Wright, *Federal Courts* § 52A (3d ed.), it is worth noting the admonition in *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 608 (1975), that federal courts should avoid intervention where state proceedings have reached an advanced stage:

> Intervention at the later stage is if anything more highly duplicative, since an entire trial has already taken place, and it is also a direct aspersion on the capabilities and good faith of state appellate courts. Nor . . . is federal intervention at the appellate stage any the less a disruption of the State's efforts to protect interests which it deems important.

3 Although the parties do not address the issue, *Pullman* abstention, *see Railroad Comm'n of Texas v. Pullman Co.*, 312 U.S. 496 (1941), also may be called for here. *Pullman* abstention allows the federal courts to stay, not dismiss, the action until the state courts in the state proceedings resolve unsettled questions of state law that may make it unnecessary to decide a federal constitutional question. An unsettled question of state law here is whether the NCUC order can bind Alcoa and Tapoco to pay the refund due from Nantahala. If the North Carolina courts decide that the NCUC has no authority to bind Alcoa and Tapoco, then those companies, the plaintiffs herein (Nantahala is not a plaintiff), will have no cause of action in the federal courts; resolution of a pending state law question thus may make it unnecessary to resolve the federal constitutional question.

Alcoa's primary argument against abstention is that abstention is never appropriate where the federal plaintiff asserts a preemption claim. *See Int'l Brotherhood of Electrical Workers v. Public Service Comm'n of Nevada*, 614 F.2d 206, 212 n.1 (9th Cir. 1980). We decline to adopt such a *per se* rule.[4] The presence of a preemption claim, however, may in some cases require a refusal to abstain. Such a preemption claim must be well founded, of course, and whether the challenged state action conflicts with federal law must be readily discernible from the pleadings. For example, abstention is inappropriate where the federal government has preempted the field, *see Capital Service, Inc. v. N.L.R.B.*, 347 U.S 501 (1954) (labor policy), or where there is a direct, facial conflict between state and federal statutes, *see Empire, Inc. v. Ashcroft*, 524 F.Supp. 898 (W.D. Mo. 1981). In such cases, the basic premise of abstention—avoiding needless federal court intervention into important matters within the state's jurisdiction to regulate—obviously is lacking. The challenged state action clearly conflicts with preemptive federal law. This, however, is not such a case. The NCUC order on its face sets only retail, intrastate rates, an important matter traditionally within the sole discretion of the states, and does not directly conflict with FERC's wholesale and interstate rate setting powers. Evaluation of the preemption claim would involve detailed factfinding concerning the indirect effects of the NCUC order on the rates established by FERC and the contracts filed with FERC. Where, as here, circumstances are otherwise appropriate for *Burford* abstention, the federal court need not engage in such factfinding as a prerequisite to abstention.

III.

For the foregoing reasons, the district court's order of dismissal is

AFFIRMED.

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4 Two other circuit courts have refused to exercise their jurisdiction despite claims of federal preemption. *See Allegheny Airlines, Inc. v. Penn. Pub. Util Comm'n*, 465 F.2d 237 (3d Cir.), *cert. denied*, 410 U.S. 943 (1973); *California v. Oroville-Wyandotte Irr. Dist.*, 409 F.2d 532 (9th Cir. 1969).

APPENDIX B

JUDGMENT

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 82-1733

Aluminum Company of America, a Pennsylvania Corporation, and Tapoco, Inc., a Tennessee Corporation;

Appellants,

vs.

Utilities Commission of the State of North Carolina; Robert K. Koger, Leigh M. Hammond, Sarah Lindsay Tate, John W. Winter, Edward B. Hipp, A. Hartwell Campbell, and Douglas O. Leary, in their respective official capacities as Chairman and Commissioners of the North Carolina Utilities Commission,

Appellees,

Rufus L. Edmisten, Attorney General of North Carolina,

Amicus Curiae,

United Steelworkers of America, AFL-CIO, and Local Union 309,

Amicus Curiae.

Appeal from the United States District Court for the Eastern District of North Carolina.

This cause came on to be heard on the record from the United States District Court for the Eastern District of North Carolina, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

/s/ William K. Slate, II
Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 82-1733

Aluminum Company of America, etc., et al,

Appellants,

versus

Utilities Commission of the State of North Carolina, et al,

Appellees,

Rufus L. Edmisten, etc.,

Amicus Curiae,

United Steelworkers of America, etc.,

Amicus Curiae.

No. 82-1765

State of Tennessee, et al,

Appellants,

and

Aluminum Company of America, etc., et al,

Plaintiffs,

versus

Utilities Commission of the State of North Carolina, et al,

Appellees,

Rufus L. Edmisten, etc.,

Amicus Curiae,

United Steelworkers of America, etc.,

Amicus Curiae.

ORDER

Upon consideration of the appellants' petition for rehearing and suggestion for rehearing en banc, and no judge having requested a poll on the suggestion for rehearing en banc,

It is ADJUDGED and ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Ervin for a panel consisting of Judge Murnaghan, Judge Ervin, and Judge Kellam.

For the Court,

/s/ William K. Slate, II
Clerk

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

No. 82-376-CIV-5

ALUMINUM COMPANY OF AMERICA, *et ano.*,

Plaintiffs,

vs.

UTILITIES COMMISSION OF THE STATE OF NORTH CAROLINA, et al.,

Defendants.

MEMORANDUM OF DECISION

Plaintiff Aluminum Company of America (Alcoa) operates a large aluminum smelting plant in eastern Tennessee and owns two nearby electric utility companies, Tapoco, Inc., a plaintiff here, and the Nantahala Power and Light Company (Nantahala). Nantahala provides retail electric service in six counties in western North Carolina and its retail rates are regulated by the defendant North Carolina Utilities Commission (NCUC). Tapoco provides power exclusively to Alcoa's operation, which requires an enormous amount of energy.

In 1976 Nantahala applied to the NCUC for an increase in the rates it charges its retail customers. Proceedings on that application have been lengthy and Nantahala's appeal from the NCUC's most recent rate order is currently before the North Carolina Court of Appeals. As an outgrowth of those proceed-

ings, Tapoco and Alcoa have brought this action for a declaration that the NCUC's order is unlawful and for an order enjoining the NCUC from enforcing it. Plaintiffs have moved for summary judgment on their claims, defendants have moved to dismiss the action on several grounds, and additional parties have moved to intervene. For an understanding of the parties' contentions and of the court's disposition of the pending motions, it is necessary first to review at some length the complex factual and procedural background of the case.

As the North Carolina Supreme Court stated when this matter was before it, "[t]he somewhat intricate factual background of this case is not generally in dispute." *State of North Carolina ex rel. Utilities Commission v. Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583 (1980). Nantahala and Tapoco are wholly owned subsidiaries of Alcoa. Nantahala is incorporated in North Carolina and owns eleven hydroelectric generating plants, all but one of which are located on the Little Tennessee River watershed and all of which are in this state. Although for many years Nantahala transferred much of its total kilowatt hour production to Alcoa's plant in Tennessee, it has since 1971 exclusively served retail and wholesale customers in North Carolina. Tapoco on the other hand is a Tennessee corporation which owns four hydroelectric generating plants in the same watershed, two in North Carolina and two in Tennessee. Tapoco supplies electricity to a single customer, Alcoa.

The Tapoco and Nantahala dams are on streams which are part of the larger Tennessee River watershed which has been developed for hydroelectric power production by the Tennessee Valley Authority. The TVA has hydroelectric facilities in the same vicinity as the Tapoco and Nantahala dams. In 1941 Alcoa and TVA entered into an agreement, known as the "Fontana Agreement," by which TVA was given the right to operate Alcoa's dams in coordination with TVA's facilities. The agreement provided that the hydroelectric power generated at Alcoa's dams would be transferred to TVA and that TVA would return to Alcoa an equal amount of power at specified times and amounts. This agreement was superseded in 1963 by the "New Fontana Agreement," effective through December

31, 1982, under which TVA continues to coordinate the operation of Alcoa's generating facilities but returns to Alcoa a fixed quantity, or "entitlement," of electricity regardless of the amount produced by Alcoa's facilities. *See* Exhibit B to Jones Affidavit. A supplemental agreement between Alcoa, Nantahala and Tapoco apportioned the TVA entitlement between Nantahala and Tapoco. Under the 1963 apportionment, Nantahala was to receive electricity at the favorable entitlement prices in an amount equivalent to the greater of either Nantahala's actual production or an amount calculated to reflect the theoretical minimum production of the Nantahala system. Electricity needed by Nantahala (or Tapoco) when the demands of its customers exceed the entitlement amount must be purchased from TVA at a price substantially higher than the entitlement price. Thus, under the 1963 agreement, Nantahala was assured of receiving the advantageous price for at least all the electricity it actually produced and was charged a premium price for its additional, actual needs.

In 1971 Nantahala and Tapoco entered into a new apportionment agreement, reducing Nantahala's TVA entitlement to an amount equivalent to Nantahala's theoretical minimum annual potential generation, regardless of actual production. Exhibit C to Jones Affidavit. *See Utilities Commission v. Edmisten*, *supra*, 299 N.C. at 436 and n.1; Federal Energy Regulatory Commission Opinion No. 139 (May, 1982) at 3-4 (Exhibit D to Jones Affidavit). The remainder of the entitlement goes to Tapoco for transfer to Alcoa's plant. It is this 1971 apportionment agreement that has generated the present controversy.

When Nantahala applied to the NCUC for a rate increase in 1976, the NCUC permitted certain ratepayers along with the Attorney General of North Carolina (on behalf of the consuming public) to intervene in the proceedings. The intervenors contended that the relationships between Nantahala, Tapoco and Alcoa were unfair to Nantahala and its ratepayers and that the NCUC should consider Tapoco and Nantahala as a single system for calculating Nantahala's rate base in order to rectify the inequity. The NCUC heard evidence and rejected this

contention, concluding that the New Fontana and apportionment agreements "were just and reasonable and to the benefit of Nantahala's customers." *Utilities Commission v. Edmisten*, *supra*, 299 N.C. at 440. The NCUC therefore declined to employ a "roll-in" method of ratemaking.[1]

On appeal by the intervenors, the North Carolina Court of Appeals reversed the NCUC and remanded the proceedings for "a determination whether the consuming public of North Carolina could benefit by having the assets and costs of Tapoco rolled-in with those of Nantahala in determining Nantahala's rate structure." *State of North Carolina ex rel. Utilities Commission v. Edmisten*, 40 N.C. App. 109, 118, 252 S.E.2d 516 (1979). Nantahala appealed the decision of the Court of Appeals, and the North Carolina Supreme Court affirmed that portion of the lower court's decision that directed the NCUC to consider using a roll-in method. *Utilities Commission v. Edmisten*, *supra*, 299 N.C. at 434. The Supreme Court noted that

> while Nantahala's contractual arrangements with TVA and Tapoco may benefit Nantahala with a guarantee that its minimal production capacity will be sustained during adverse conditions, these same arrangements appear to result in the anomalous situation that in periods of favor-

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1 By law the NCUC must ascertain the fair value of a utility's "use and useful" property and the utility's reasonable operating expenses to determine a cost of service, from which rates are calculated. N.C.G.S. § 62-133(b). The NCUC must consider "all other material facts of record" which may have a significant bearing on the determination of reasonable and just rates. N.C.G.S. § 62-133(d); *Utilities Commission v. Edmisten*, *supra*, 299 N.C. at 437. A "roll-in" method takes into account the fair value of property and operating expenses other than that used by the utility in generating electricity in North Carolina. For example, in calculating rates for Duke Power and Carolina Power and Light, two utilities operating both in North and South Carolina, the NCUC calculates the cost of service over the utility's entire, integrated system and apportions the cost between the two states. The "roll-in" in the present case produces "a rate schedule computed upon a rate base which takes into account the property values and operating expenses of both Tapoco and Nantahala." *Id.*

> able stream flow and rainfall in which Nantahala's facilities produce more energy than its customers require, these customers must nevertheless pay extra for extra energy purchased by Nantahala from TVA. Any usable excess generated by Nantahala in such a year appears to accrue not to the benefit of its customers, but rather to that of its parent Alcoa, which "purchases" the remainder of the New Fontana entitlements from Tapoco. Suffice it to say that the assertion that Nantahala's public is fairly served by a contract requiring Nantahala to purchase additional power regardless of the adequacy of its own generation assaults the common sense of this Court. Nantahala's customers should not be denied the benefit of their utility's fairly regular harvests of abundant energy.

299 N.C. at 440-441.

On remand, the NCUC heard additional evidence, adopted the roll-in methodology advocated by the intervenors and entered an order reducing Nantahala's rates and requiring a refund to the Nantahala ratepayers for earlier years' overpayment. *See* Exhibit F to Jones Affidavit. In so ordering the NCUC found that Nantahala and Tapoco constitute a single integrated system, calculated the "fair value" of the entire system, and determined what portion of the system is devoted to intrastate retail electric service in North Carolina. Exhibit F at 7-8. Rates were based on a cost of service calculated from that apportionment. On May 4, 1982, the NCUC entered an order requiring Nantahala and Alcoa to file a joint plan to refund $18,962,000.00 plus accrued interest to the Nantahala ratepayers no later than January 28, 1983. *See* Exhibit H to Jones Affidavit. Alcoa was joined in the most recent refund order because the NCUC had concluded that "Nantahala is financially unable to make all of the refunds required . . . ." Exhibit H at 3. Nantahala has appealed the rate and refund orders to the North Carolina Court of Appeals.

During the lengthy course of the retail rate proceedings, the New Fontana and apportionment agreements have also been the subject of proceedings before the Federal Energy Regula-

tory Commission (FERC), the successor to the Federal Power Commission. The FERC oversees the licensing of Tapoco's and Nantahala's hydroelectric facilities under Part I of the Federal Power Act, 16 U.S.C. §§ 791a, *et seq.*, and regulates the transmission and sale of electric energy in interstate commerce under Part II of the Act, 16 U.S.C. §§ 824, *et seq.* Nantahala has three wholesale customers whose rates are governed by the FERC, and in 1976 Nantahala applied to the FERC for a wholesale rate increase. In 1978, two of these customers, the Town of Highlands and the Haywood Electric Membership Corporation, along with the Attorney General of North Carolina, filed a complaint with the FERC alleging that Alcoa, Nantahala and Tapoco "are in violation of the Federal Power Act by diverting, for the benefit and private use of Alcoa, hydroelectric power and facilities dedicated to public service." FERC Opinion No. 139, at 2; Exhibit D to Jones Affidavit. The two proceedings were consolidated and the FERC, like the NCUC, considered whether a roll-in method should be used to determine Nantahala's cost of service. The Town of Highlands contended in the FERC proceedings that Nantahala and Tapoco should be treated as one entity for ratemaking purposes and that the 1971 apportionment agreement should be set aside, or in the alternative that the 1971 agreement should be modified to remedy the misallocation of power caused by the agreement. After a lengthy evidentiary proceeding the FERC determined that

> [b]ased on the evidence presented, we cannot find that Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, or that the two companies operate as an integrated system. Nantahala and Tapoco were developed in different states and for different purposes; their customer loads and sources of generation are geographically separate; their management is separate; and they are interconnected at only one point. The two companies do not constitute an integral unit between themselves but are each a part of the coordinated TVA system, and it is TVA

who controls and dispatches most of the generation from their respective generating plants.

FERC Opinion No. 139 at 7 (footnotes omitted); Exhibit D to Jones Affidavit. The FERC did conclude, however, that "the alleged fairness of the 1971 Agreement is not supported by the record," and the 1971 agreement was modified "to provide entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers." *Id.* at 11-12. Alcoa assures this court that the FERC's decision will be appealed to the United States Courts of Appeals.

On January 26, 1982, while Nantahala's exceptions to the September 2, 1981 order of a three-member panel of the NCUC were pending before the full NCUC, and while exceptions to the decision of the FERC's administrative law judge were pending before the FERC, Alcoa and Tapoco filed this action in the United States District Court for the Eastern District of Tennessee. On motion of the defendants Judge Taylor of that court transferred the action to this court. Plaintiffs contend here that the rate and refund orders of the NCUC contravene both the Federal Power Act and the commerce clause, Article I, Section 8, of the United States Constitution, arguing that the FERC's acceptance of the New Fontana and apportionment agreements as the foundation for determining Nantahala's cost of power must be accepted also by the NCUC in the retail ratemaking proceedings. Moreover, it is contended that the NCUC orders have the effect of shifting to Tapoco and Alcoa some portion of Nantahala's cost of service. The orders are thus contended to be attempts by the NCUC to regulate wholesale, interstate power transactions and are contended to have an impermissible adverse effect on interstate commerce.

With this background in mind, the court can proceed to determine the pending motions and will turn first to the motions to intervene.

MOTIONS TO INTERVENE

The United Steelworkers of America, the collective bargaining agent for some 3,500 Alcoa employees working in the Tennessee plant, and the State of Tennessee seek intervention as parties plaintiff. Neither of the movants seek to add significantly to the arguments of the present parties. Rather, they wish to preserve their rights should the present positions of the parties change and to apprise the court of the magnitude of the economic interests at stake. The United Steelworkers point out that its members may lose their jobs with Alcoa if the NCUC rate and refund orders are enforced because Alcoa's Tennessee plant may become too costly to operate. Similarly, the State of Tennessee as *parens patrie* seeks to protect the economic well-being of its citizens, fearing the substantial adverse impact which would result if a curtailment of production at Alcoa's Tennessee operations is caused by increased electric rates. The State of Tennessee also wishes to assert its sovereign interest in controlling the natural resources and economic activities within its borders, which it contends have been unlawfully invaded by the NCUC orders. Conversely, the Attorney General of North Carolina seeks as *amicus curiae* to represent the interests of the users and consumers of electric power in North Carolina who stand to benefit from the NCUC orders.

If this court sat as an economic planning agency, the movants' depictions of the many substantial secondary effects of the orders in question would be of crucial significance. As arbiter of the specific questions presented for decision, however, the court finds that the parties in their present postures fully represent the interests of the movants, and the motions to intervene will be denied. *See* F.R.Civ.P. 24(a). Instead, movants will be heard as *amicus curiae*. Should the present contentions of the parties significantly change, the motions to intervene may be renewed.

MOTION TO DISMISS

Defendants move to dismiss the action on five grounds. They assert that the Johnson Act, 28 U.S.C. § 1342, and the

Eleventh Amendment to the United States Constitution bar the relief sought and therefore require dismissal. They contend that the court does not have subject matter jurisdiction on any of the jurisdictional grounds alleged. They argue that the action should be dismissed for failure to join Nantahala, who is asserted to be both the real party in interest and an indispensable party, yet not subject to joinder without destroying complete diversity, which defendants assert is the only basis for subject matter jurisdiction. Finally, defendants contend that even if the court has jurisdiction, it should abstain from exercising that jurisdiction. These contentions will be addressed seriatim.

By enacting the Johnson Act in 1934, Congress "put statutory limitations on the circumstances in which a federal court could issue injunctions against state orders setting rates for public utilities." 17 Wright & Miller, *Federal Practice and Procedure* § 4236, at 407 (1978). The Johnson Act does not, however, prevent a federal court from enjoining a state utility rate order if the court's jurisdiction is invoked on some grounds other than "diversity of citizenship or repugnance of the order to the Federal Constitution." 28 U.S.C. § 1342(1). In addition, a federal court may intervene if the state rate order interferes with interstate commerce. 28 U.S.C. § 1342(2).

Viewing the allegations of the complaint as true for purposes of this motion, the court finds that the Johnson Act does not bar the relief sought. Plaintiffs allege that the indirect effect of the NCUC rate and refund orders is to interfere with the interstate transactions between Nantahala, Tapoco, TVA and Alcoa. It is further alleged that the orders in question invade the exclusive regulatory jurisdiction of the FERC, a jurisdiction which preempts any activity by the NCUC in the field. While recognizing that "a rate issued by a proper state body does not interfere with interstate commerce [within the meaning of 28 U.S.C. § 1342(2)] unless it is directly burdensome or otherwise discriminatory of the (sic) interstate traffic," *Kalinsky v. Long Island Lighting Company*, 484 F.Supp. 176, 178 (E.D.N.Y. 1980), *quoting New York Central Railroad Company v. Illinois Commerce Commission*, 77 F.Supp. 520, 522

(N.D.Ill. 1948), the court finds the allegations sufficient to surmount the Johnson Act's bar on "interstate commerce" grounds. In addition, the alleged preemptive effect of the Federal Power Act gives this court federal question jurisdiction, so the condition established by 28 U.S.C. § 1342(1) is not met.

Nor does the Eleventh Amendment bar this action. Defendants attempt to stretch the recent Supreme Court decision in *Cory v. White*, ____ U.S. ____, 50 U.S.L.W. 4621 (June 14, 1982), to encompass the present action, contending that *Cory* holds that the Eleventh Amendment bars actions for injunctive relief against state officers. Unlike the present case, however, *Cory* (as viewed by the majority of the Court) involved no claim that state officers were acting contrary to federal law. The *Cory* opinion does not spawn any doubt concerning the continuing vitality of *Ex Parte Young*, 209 U.S. 123 (1908), which permits actions for injunctive relief against state officers alleged to be acting contrary to federal law, as are defendants here.

Also meritless is the contention that this court is without subject matter jurisdiction. By alleging that defendants' acts contravene the commerce clause as well as preemptive federal legislation, plaintiffs have brought this action within this court's federal question and commerce jurisdiction. 28 U.S.C. §§ 1331, 1337. Thus diversity jurisdiction is not essential to the maintenance of the action, so the question of whether Nantahala is an indispensable party need not be reached for purposes of addressing the jurisdictional motion, because joinder of Nantahala would not divest the court of jurisdiction. Finding, therefore, that it has jurisdiction over this action and that Nantahala could be joined if necessary, the court must turn to the serious questions raised by defendants' assertion that the court should abstain from exercising jurisdiction.

ABSTENTION

Defendants contend primarily that this action should be dismissed for reasons of federal-state comity and point out that: (1) federal courts have traditionally abstained from en-

joining orders of state utility commissions, (2) there is currently a proceeding pending in the state appellate courts in which plaintiffs have raised their federal claims, (3) the state courts can give the relief sought as fully and effectively as can this court, and (4) intrusion by this court would seriously undermine the state's ability to pursue its important interest in regulating intrastate electric utility rates. In so arguing, plaintiffs invoke the principles enunciated in *Burford v. Sun Oil Company*, 319 U.S. 315 (1943), *Alabama Public Service Commission v. Southern Railway Company*, 341 U.S. 341 (1951), and the series of "equitable restraint" cases which began with *Younger v. Harris*, 401 U.S. 37 (1971).

As this court has previously noted,

> abstaining and dismissing a case which clearly raises seemingly meritorious constitutional questions is, and should be, the exception and not the rule. Only when more important countervailing principles are raised and a jurisprudentially adequate state forum is provided should the federal courts defer to their state counterparts. Very simply, federal courts have a duty to exercise their jurisdiction unless circumscribed by distinct and coherent limits.

Wall & Ochs, Inc. v. Hicks, 469 F.Supp. 873, 878 (E.D.N.C. 1979). *See also Colorado River Water Conservation District v. United States*, 424 U.S. 800, 813-814 (1976). Abstention is appropriate, however, when state judicial proceedings have been initiated prior to substantive federal proceedings on the merits, the state proceedings provide an adequate opportunity to litigate the federal claims, and intrusion by the federal court would seriously undermine the state's ability to regulate its internal affairs. *Wall & Ochs, supra*, 469 F.Supp. at 879. Employing the same test, the Supreme Court recently held that a federal court must abstain from considering constitutional challenges to a pending state bar disciplinary proceeding where the proceeding was judicial in nature, provided an adequate opportunity to raise the constitutional challenges, and implicated important state interests. *Middlesex County Ethics Com-*

mittee v. Garden State Bar Association, ___ U.S. ___, 50 U.S.L.W. 4712, 4714 (June 21, 1982).

In the present case it is beyond question that state judicial proceedings are now underway in which plaintiffs' federal claims can be adjudicated. The NCUC, in its "Final Order Overruling Exceptions and Giving Supplementary Conclusions," dated January 28, 1982 addressed the federal issues raised here, and those questions are now before the North Carolina Court of Appeals.[2] *See* Exhibit G to Jones Affidavit.

Plaintiffs contend, however, that there can be no cognizable state interest when the state's action is repugnant to a preemptive federal statutory scheme. Plaintiffs rely on *International Brotherhood of Electrical Workers v. Public Service Commission of Nevada*, 614 F.2d 206 (9th Cir. 1980), where the court observed "in passing" that "[a] preemption claim alleges in essence that Congress has determined that particular matters are of national concern and should be administered by national, rather than local, institutions. If a preemption claim is well-founded, therefore, *Burford* abstention cannot be appropriate." *Id.* at 212, n.1. In the present context, plaintiffs' contention is unpersuasive. Many of the cases relied upon arose in contexts where there were no pending state judicial proceedings, so *Younger* principles were not discussed.[3] In those cases where state judicial proceedings were underway, the conflict between state and federal law was a direct, facial inconsistency between statutes. *See Kennecott Corporation v. Smith*, 637 F.2d 181 (3d Cir. 1980); *Empire, Inc. v. Ashcroft*, 524 F.Supp. 898 (W.D.Mo. 1981). In each of these cases, state

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2 In the same order the NCUC rejected the contention that it should reserve the federal questions for decision by a federal court. Exhibit G to Jones Affidavit at 5-6.

3 *See Braniff International, Inc. v. Florida Public Service Commission*, 576 F.2d 1100 (5th Cir. 1978); *Construction Aggregates Corporation v. Rivera de Vicenty*, 573 F.2d 86 (1st Cir. 1978); *Hotel and Restaurant Employees v. Danzinger*, 536 F. Supp. 317 (D.N.J. 1982); *Begay v. Kerr-McGee Corporation*, 499 F.Supp. 1317 (D. Ariz. 1980); *RCA del Caribe, Inc. v. Silva Recio*, 429 F.Supp. 651 (D.Puerto Rico 1976).

statutes regulating tender offers directly conflicted with the provisions of the federal Williams Act, 15 U.S.C. §§ 78m(d)-(e) and 78n(d)-(f), and no factfinding was necessary to determine the preemption issue. Here, in contrast, no challenge is made to state statutes or regulations. Consideration of the federal questions instead would require detailed factfinding concerning the indirect effects of the NCUC rate and refund orders on interstate commerce, on the rates established by the FERC, and on contracts filed with the FERC.

The orders here are unlike those in *New England Power Company v. New Hampshire*, ____ U.S. ____, 102 S.Ct. 1096 (Feb. 24, 1982), and *Public Utilities Commission of Ohio v. United Fuel Gas Company*, 317 U.S. 456 (1943), where attempts were made by states to control directly interstate transactions in energy. The NCUC's orders on their face do no more than establish intrastate, retail rates for Nantahala using a particular method of determining Nantahala's cost of production. Plaintiffs have offered and the court has found no controlling authority for the proposition that the NCUC is bound to accept in its independent regulatory bailiwick a rate of purchasing electricity approved by the FERC as Nantahala's cost of service. This does not mean, however, that the NCUC's orders have not impermissibly interfered with interstate commerce or that they have not indirectly affected matters exclusively within the FERC's jurisdiction.

An additional argument raised by plaintiffs is that *Younger* abstention does not apply in proceedings not initiated by the state. This position, accepted by the Third Circuit, *Johnson v. Kelly*, 583 F.2d 1242 (3d Cir. 1978); *Hotel and Restaurant Employees v. Danzinger, supra*, strikes this court as an attempt to unduly restrict the application of the policies underlying *Younger*. Just as it does not matter whether proceedings are "labeled civil, quasi-criminal, or criminal in nature," *Juidice v. Vail*, 430 U.S. 327, 335 (1977), quoted in *Middlesex County Ethics Committee, supra*, 50 U.S.L.W. at 4714 n.12, it should not matter whether proceedings happen to be initiated by the state or by a private plaintiff. The crucial question is "whether federal court interference would unduly interfere with the

legitimate activities of the state." *Id.* Nevertheless, it is noteworthy that while the state proceedings were commenced by Nantahala's application for a rate increase, Alcoa and Tapoco, the plaintiffs here, were brought into the state proceedings by order of the NCUC. *See* Exhibit F to Jones Affidavit, at 4.

For these reasons, the court has concluded that the motion to dismiss on abstention grounds is well taken and must be granted. An appropriate order will be entered.

/s/

F.T. DUPREE, JR.
United States District Judge

APPENDIX E

STATE OF NORTH CAROLINA

UTILITIES COMMISSION

RALEIGH

Docket No. E-13, Sub 29 [Remanded]

BEFORE

THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of Application of Nantahala Power and Light Company for Authority to Adjust and Increase Its Electric Rates and Charges

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ORDER REDUCING RATES AND REQUIRING REFUND

HEARD IN: The Commission Hearing Room, Dobbs Building, 430 North Salisbury Street, Raleigh, North Carolina 27602, March 31, 1981; April 1, 2, 3, 7, 8 and 9, 1981; and May 18, 19, 20, 21, and 22, 1981

BEFORE: Commissioner Sarah Lindsay Tate, Presiding; and Commissioners A. Hartwell Campbell and Douglas P. Leary

APPEARANCES:

For Nantahala Power and Light Company:

Robert C. Howison, Jr., and James E. Tucker, Suite 400, Branch Banking and Trust Building, P.O. Box 109, Raleigh, North Carolina 27602

For Aluminum Company of America and Tapoco, Inc.:

Ronald D. Jones, David R. Poe, M. Reamy Ancarrow, LeBoeuf, Lamb, Leiby & MacRae, 140 Broadway, New York, New York 10005

For Cherokee, Graham, Jackson, and Swain Counties, North Carolina; the Towns of Andrews, Dillsboro, Robbinsville, and Sylva, North Carolina; Tribal Council of Eastern Band of Cherokee Indians; and Henry J. Truett:

William T. Crisp, Robert W. Schwentker, Crisp, Smith, Davis and Schwentker, P.O. Box 751, Raleigh, North Carolina 27602

For the Town of Bryson City:

Joseph A. Pachnowski, P.O. Box 849, Bryson City, North Carolina 28713

For the County of Swain:

Fred H. Moody, Jr., McKeever, Edwards, Davis & Hays, P.A., Box 670, Bryson City, North Carolina 28713

For Intervenor Muriel Maney:

Larry Nestler, Western North Carolina Legal Services, P.O. Box 546, Cherokee, North Carolina

For the Using and Consuming Public:

Richard L. Griffin, Attorney General, P.O. Box 629, Raleigh, North Carolina 27602

Robert F. Page and Thomas K. Austin, Public Staff North Carolina Utilities Commission, P.O. Box 991, Raleigh, North Carolina 27602

BY THE PANEL: This proceeding is before the Commission upon remand from the Supreme Court of North Carolina. *Utilities Commission* v. *Edmisten, Attorney General*, 299 N.C. 432 (1980).

* * *

Upon consideration of the testimony and exhibits presented at the hearing and the entire record in this docket, the Commission makes the following

FINDINGS OF FACT

1. Nantahala is a duly organized public utility company under the laws of North Carolina, subject to the jurisdiction of this Commission, and is holding a franchise to furnish electric power in the western part of the State of North Carolina under rates and service regulated by this Commission as provided in Chapter 62 of the General Statutes.

2. Tapoco is a duly organized public utility and is domesticated as such under the laws of North Carolina. It is subject to the jurisdiction of this Commission with respect to its retail rates and electric service as provided in Chapter 62 of the General Statutes.

3. Both Nantahala and Tapoco are wholly owned subsidiaries of Alcoa. Alcoa is a public utility pursuant to G.S. 62-3(23)c. and is subject to the jurisdiction of this Commission with respect to retail ratemaking.

4. The Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the Tennessee Valley Authority (TVA) system.

5. For purposes of setting the Applicant's rates in this proceeding the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of the Applicant's reasonable cost of service applicable to its North Carolina retail operations.

6. The New Fontana Agreement (NFA), executed by TVA, Alcoa, Nantahala, and Tapoco, and the resultant 1971 Apportionment Agreement between Tapoco and Nantahala, have resulted in substantial benefits to Alcoa to the significant detriment of the customers of Nantahala.

7. The methodology employed by the Intervenors in making jurisdictional cost allocations and cost-of-service allocations is the most appropriate for use in this proceeding. Consequently, each finding of fact appearing in this Order which deals with the proper level of rate base, revenues, and expenses has been determined based upon said methodology.

8. The reasonable original cost of the Nantahala-Tapoco property used and useful in providing electric service to its retail customers in North Carolina is $36,951,000. The reasonable accumulated provision for depreciation is $18,202,000, and the reasonable original cost less depreciation is $18,749,000.

9. The reasonable replacement cost of Nantahala's property used and useful in providing retail electric service in North Carolina is $57,795,000.

10. The fair value of Nantahala-Tapoco's utility plant used and useful in providing electric service to its retail customers in North Carolina should be derived from giving 40% weighting to the original cost less depreciation of Nantahala-Tapoco's utility plant in service and 60% weighting to the trended original cost less depreciation of Nantahala-Tapoco's utility plant. By this method, using the depreciated original cost of $18,749,000 and the reasonable replacement cost of $57,795,000, this Commission finds that the fair value of said utility plant devoted to intrastate retail electric service in North Carolina is $42,177,000. This fair value includes a reasonable fair value increment of $23,428,000.

11. The reasonable allowance for working capital is $1,113,000.

12. The fair value of Nantahala-Tapoco's plant in service used and useful in providing electric service to its retail customers within the State of North Carolina of $42,177,000 plus the reasonable allowance for working capital of $1,113,000 less customer deposits of $188,000 yields a reasonable fair value of Nantahala-Tapoco's property in service to North Carolina retail customers of $43,102,000.

13. The approximate gross revenues for the test year, after accounting and pro forma adjustments, under rates approved by Commission Order of June 14, 1977, are $11,067,000.

14. The approximate level of test year operating expenses under rates approved by Commission Order of June 14, 1977, after accounting and pro forma adjustments, including taxes and interest on customer deposits, is $8,322,000 which includes an amount of $1,133,000 for actual investment currently consumed through reasonable actual depreciation after annualization to year-end levels.

15. The reasonable original cost capital structure for use herein is as follows:

Item	*Percent*
Debt	40.05
Common equity	37.00
Cost-free	22.95
Total	100.00

and when the fair value increment is added, the reasonable fair value capital structure becomes:

Item	*Percent*
Debt	18.28
Common equity	71.24
Cost-free	10.48
Total	100.00

16. The fair rate of return that Nantahala should have the opportunity to earn on the fair value of its investment devoted to its North Carolina retail operations is 4.20%.

17. The approximate annual level of revenues which Nantahala should be authorized to collect through rates charged for its sales of service, based upon the findings of fact set forth hereinabove, is $9,032,000.

18. The rates and charges of Nantahala, based upon the adjusted test year level of operations, under rates approved by

Commission Order of June 14, 1977, are excessive to the extent that said rates produce a level of revenue which is $2,035,000 ($11,067,000-$9,032,000) greater than the Applicant's revenue requirement (cost of service). Thus, Nantahala should be required to reduce said rates and charges in a manner so as to achieve an annual gross revenue reduction of approximately $2,035,000, based upon the adjusted test year level of operations.

19. Nantahala should be required to refund to its North Carolina retail customers all revenue collected under the rates approved by Commission Order issued June 14, 1977, to the extent that said rates produced revenue in excess of the rates approved herein. Said refund shall include revenues collected under the Company's base rate structure as well as through operation of the purchased power adjustment formula plus interest computed and compounded at the legal annual rate.

20. The purchased power adjustment clause is a just and reasonable rate and a reasonable method by which Nantahala can recover a part of its reasonable operating expense.

21. Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina. Therefore, this Commission is compelled to order that, to the extent Nantahala is financially unable to make the revenue refunds required in this Order, Alcoa shall refund all or any portion of the aforementioned revenue refunds that Nantahala is financially unable to make.

* * *

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 6 AND 7

The Commission, as previously discussed, has determined for purposes of this proceeding that the Nantahala and Tapoco systems should be treated as one entity. The Commission must now determine the proper allocation methodology to be used

in apportioning the combined revenues, expenses, and investment of the Nantahala-Tapoco system between that applicable to said system's North Carolina retail operations and that applicable to said system's operations over which this Commission has no jurisdiction.

Generally speaking, the allocation methodology that the companies (Alcoa, Tapoco) would have the Commission adopt for use herein is based in all material respects upon demand and energy entitlements as described and set forth in the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement; whereas, the allocation methodology that the Intervenors would have the Commission adopt is based in all material respects upon the assumption that the electric energy requirements of the Nantahala-Tapoco combined system's North Carolina public load has first call on the total electric energy output of the combined system, and to the extent that said output exceeds the requirements of the North Carolina public load, such excess will be available for sale and will be purchased by Alcoa. The Commission will first address the propriety or, perhaps more appropriately, the impropriety of basing cost allocations on demand and energy entitlements as contained in the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement.

There are a number of inequities to Nantahala that arise out of both the New Fontana Agreement (hereafter NFA) and the 1971 Tapoco-Nantahala Apportionment Agreement (hereafter Apportionment Agreement) that result in Alcoa's receiving concealed benefits. Because the inequities of the NFA are more subtle and difficult to express than are those of the Apportionment Agreement, we discuss the 1971 Apportionment Agreement first.

A. *Concealed Benefits of the Apportionment Agreement*

(1) Quantity of Nantahala's Production

Alcoa's power consultant George Popovich devised the Apportionment Agreement share for Nantahala at 360 million kwh annually. Nine years earlier, Mr. Popovich had determined

that a considerably higher apportionment share would be required for Nantahala. On May 14, 1962, in a memo to an Alcoa executive, Mr. Popovich wrote:

> "A. The Alcoa-NP&L Co. Contract of October 1954 as verbally revised should guarantee that the annual energy entitlements of NP&L Co. are 360 million Kwh (41,000 Kw) primary and 79 million Kwh (9,000 Kw) interruptible. This is a benefit in that it gives NP&L Co. this assured supply even in the event of future conditions of stream flow which might be more adverse than that experienced in the historical period of record. *These energy entitlements have been independently determined by engineers employed by NP&L Co. Alcoa has checked and accepted their determinations . . . .*" (underlining supplied) (Intervenors Popovich Rebuttal Cross-Examination Ex. 1, pp. 3-4)

The engineering study referred to by Mr. Popovich had been made by Ebasco in the year 1960 and a copy of that study is Item 4, A.G. Jontz Cross-Examination Exhibit 1 (original hearing). That study states:

> "(a) The primary energy capability under the most adverse water conditions of record. This quantity was found to be 360 million kilowatt hours per year.
>
> "(b) The average energy that could be generated annually by these hydroelectric plants. This quantity was found to be 439 million kilowatt hours per year."

We note that the 79,000,000 Kwh referred to by Mr. Popovich as interruptible is the difference between primary and average energy referred to in the Ebasco study. (When the three small Nantahala plants not included in the NFA return entitlement from TVA are deducted, the 79,000,000 Kwh is reduced to 66,000,000 Kwh.)

Based upon these established and known facts, after the NFA was executed, in 1963 Alcoa entered into a written agreement with Nantahala wherein Nantahala was apportioned a certain share of the NFA return entitlements. This agree-

ment, identified as Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing), and also Applicant's Exhibit WMJ-RII, apportioned to Nantahala 360,000,000 Kwh minimum plus actual production in excess of 360,000,000 Kwh, that is, an average of 426,000,000 Kwh annually (360,000,000 Kwh + 66,000,000 Kwh), using this language:

> "2. Nantahala should be entitled each month to an amount of energy which when added to its generation at plants not operated under the above mentioned agreement of December 27, 1962, shall be the equivalent either to its total actual generation during that month or to the one-twelfth of its annual primary generating capability whichever shall be the greater. The annual primary generating capability of Nantahala as used in the foregoing sentence is agreed to be 360 million kilowatt hours."

By this agreement, Nantahala received annually the average of 426,000,000 Kwh, of which 360,000,000 Kwh was guaranteed as a minimum.

During the remanded hearings, Intervenors put on similar independent evidence from their expert witness Springs. Witness Springs testified, at Vol. 15, Tr. p. 33:

> ". . . NP&L's contributions, excluding the three small projects not turned over to TVA, are approximately . . . 426,000,000 Kwh of average energy (Ebasco Study) . . ."

Despite all of the above facts, when Mr. Popovich devised the 1971 Apportionment Agreement, Nantahala received *only* 360,000,000 Kwh annually. Nantahala was deprived of an average of 66,000,000 kwh annually. The detriment to Nantahala constitutes a benefit to Tapoco that is passed on to Alcoa.

Witness Springs testified that "NP&L did not come out very well in this 'trade' " (Vol. 15, Tr. p. 19)

(2) Quantity of Nantahala's Peaking Capacity

As one aspect of the 1971 Apportionment Agreement, Nantahala has a limitation placed upon its peaking capacity of 54,300 Kw with the result that any time it has to provide a

customer demand in excess of 54,300 Kw, it must pay a monthly demand charge to TVA for all power over that limitation. If the limitation were at a higher level, of 81,800 kilowatts, a monthly demand charge would be saved for 27,500 kilowatts, i.e., the difference between 81,800 Kw and 54,300 Kw, when customer demand equalled or exceeded the 81,800 kilowatt level.

Demand costs imposed on Nantahala for use of capacity between its assigned capacity of 54,300 kilowatts and its actual capacity, of 81,800 kilowatts, would represent an expense to Nantahala and, thus, a savings to its New Fontana Agreement sister, Tapoco, since the capacity constraints for the TVA return entitlements are jointly shared by them under the New Fontana Agreement. Tapoco's savings are passed on to Alcoa so as to become Alcoa savings, i.e., a concealed benefit.

The record clearly and convincingly establishes that Nantahala's correct capacity is 81,800 kilowatts and that, by being assigned a demand limitation of only 54,300 kilowatts, Nantahala suffers significant monthly financial loss.

The 1960 Ebasco Study (Item 4, A.G. Jontz Cross-Exam Ex. 1, Table A-1, (original hearing)), undertaken for Nantahala by independent experts, computed Nantahala's plant capacity, under the most adverse water conditions, at 85,400 kilowatts. After deducting the three small plants excluded from the NFA, that capacity is 84,300 kilowatts (Vol. 15, pp. 147-148). The Ebasco study computation is confirmed in an old memorandum of W.T. Walker (Intervenors' Ex. DAS-18, pp. 4-5 of 8), Nantahala's president, wherein he notes that in 1965 another independent source had analyzed Nantahala's *allowed capacity* under the original Fontana Agreement to be only 35,172 kilowatts. Not only was the allowed capacity under the original Fontana Agreement regarded as unrealistic, but a capacity much higher than 54,300 Kw was thought to be proper. The Walker memorandum states:

> ". . . He thought this allocated capacity to be unreasonable for a company with 84.3 Mw of co-ordinated capacity under adverse water conditions, so he allocated 74.9 Mw to Nantahala . . ."

The Walker memorandum continues, at page 5 of 8, by even noting that "George Popovich's proposed allocation to Nantahala . . ." for capacity would be 76,000 Kw.

Based upon these established facts, after the NFA was executed, Alcoa entered a written agreement with Nantahala in the year 1963 wherein Nantahala was allowed to use capacity without limitation. This agreement, mentioned in the previous section, identified as Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing) and also Applicant's Ex. WMJ-Rll, thereby permitted Nantahala to use actual capacity to the limits assigned by the 1960 Ebasco study.

Intervenors' witness Springs testified that after adjustment for reserves, the allowable capacity of 84,300 kilowatts, under most adverse water conditions, should be 81,800 kilowatts (Vol. 15, Tr. p. 37).

Despite these impressive studies and facts, when Mr. Popovich accomplished his study (Intervenors' Ex. DAS-12) for the 1971 Apportionment Agreement, while accepting the most adverse water capacity factor of 84,300 kilowatts, he deducted 27,500 kilowatts for the "largest unit out" to reach an assigned capacity of 54,300 Kw. This deduction is for the Nantahala facility which forms upwards of 50% of the entire Nantahala generation system of 11 dams.

If Nantahala were a separate and independent system, a deduction of the "largest unit out" might be appropriate to determine assured capacity. However, Nantahala is not and never has been a separate electric system—it was not so designed. Nantahala's two largest facilities are Thorpe (previous Glenville), completed in 1941 with 21,600 Kw capacity, and Nantahala, completed in 1942 with 43,200 Kw capacity (See Intervenors' Ex. DAS-1, p. 8 of 14). The Thorpe and Nantahala facilities comprise about 65% of Nantahala's entire system. At the time of their construction, Alcoa obtained a certificate of necessity from the War Department and *expressly argued and avowed that they were part of the Alcoa system.* Intervenors' Ex. DAS-7, p. 5 of 11; also being Applicant's Ex. WMJ-R5. In that exhibit, at pp. 5-6 of 11, it is recorded that Alcoa said of these two Nantahala plants:

"At the present time, Alcoa receives power from three dams located on tributary waters of the Tennessee River at Calderwood, Tennessee and Tapoco, North Carolina, (Cheoah and Santeetlah developments). . . .

"To improve the present power situation and to supply a portion of the 200,000 additional Kw required for national defense purposes, *applicant proposes to build two new developments*, also on tributaries of the Tennessee River, at Glenville and Nantahala, North Carolina . . . *The estimated total addition to the Alcoa power system* is 51,500 Kw, part of which will be produced at the new developments and part from additional water released for us downstream." (emphasis added) (Apparently, the two new projects were finally designed for their actual greater combined capacity, 64,800 Kw.)

Furthermore, for the past 40 years, both Nantahala and Tapoco have been operated as an integral part of the TVA electric system pursuant to the provisions of the Fontana and New Fontana Agreements. Moreover, when Alcoa negotiated these agreements with TVA, it did not bargain for return power from TVA as if Nantahala was an independent power system but rather the attributes of the Alcoa system were melded together with the TVA system for evaluation purposes. In this regard, Intervenors' Ex. DAS-23 is a memorandum of Alcoa's meetings with TVA respecting negotiations for the NFA wherein the TVA proposals were based on integration into and coordination with the TVA system (Intervenors' Ex. DAS-23, pp. 6-7 of 85).

With Nantahala and Tapoco being thus integrated into and coordinated with the TVA system, it is not appropriate to determine Nantahala's assured capacity by configuring Nantahala as a single independent and isolated system and to use the "largest unit out" methodology. Instead, Nantahala should be treated as part of the TVA system and the reserve margin used by TVA should be applied. TVA does not use a reserve of "largest unit out" but rather uses "the loss of load probability method." (See Intervenors' Ex. DAS-13, p. 1 of 3). Due to the

favorable operating characteristics of a hydro system as opposed to a steam system, those characteristics being, for instance, low operating speeds, ruggedly constructed equipment, and restarting capability without auxiliary power, the reserve requirements of a hydro system are very low. Intervenors' Ex. DAS-17, being a portion of the 1980 contract of the Southern Company Services Intercompany Interchange, at page 6 of 6, shows that a 3% hydro reserve is proper.

Using a 3% reserve in place of the "largest unit out" reserve, in this case upwards of 50%, would establish a capacity under most adverse water conditions of 81,800 kilowatts as opposed to Mr. Popovich's calculation of 54,300 kilowatts. This is what Intervenors' witness Springs testified the calculation should be (Vol. 15, Tr. p. 37).

Significant cost is shifted to Nantahala by the unfair and unwarranted limitation of capacity to 54,300 kilowatts. Conversely, that expense, in the form of demand charges paid to TVA, is a concealed benefit to Alcoa.

(3) Nantahala's Upstream Benefits

Nantahala's projects are upstream of Tapoco's projects, except Santeetlah. As a consequence, water that is stored by Nantahala can be released to flow downstream and be used by Tapoco for production of electricity. Therefore, Nantahala's storage has a value to Tapoco. Granted TVA's Fontana project now lies between the Nantahala and Tapoco projects. However, that does not diminish the value of Nantahala's stored water to Tapoco since, when Nantahala releases water, that water, or its equivalent, can be released by Fontana so as to flow through to Tapoco.

On January 10, 1941, before Fontana was constructed and even before the Fontana Agreement, Nantahala applied to the War Department for a certificate to build the Glenville (now Thorpe) and Nantahala projects, noting that they would be upstream of the Calderwood and Cheoah dams. That application, Intervenors' Ex. DAS-7, at p. 5 of 11, in part, makes this statement about the upstream benefits:

". . . It is contemplated that they will store water the winter months, and will be used in the dry season to produce additional power and also to make available additional water for the developments downstream . . ."

A 1956 TVA study estimated the upstream storage benefits of the two major Nantahala projects to Tapoco's downstream facilities. As shown by Intervenors' Ex. DAS-9, the Nantahala and Thorpe projects yield a *continuous* relative contribution to Tapoco's Calderwood and Cheoah projects of 4,300 Kw. This is the equivalent of 37,668,000 Kwh annually as an upstream benefit from Nantahala to Tapoco (4,300 x 8,760).

Despite the presence of Nantahala's upstream benefits to Tapoco, when Mr. Popovich devised the 1971 Apportionment Agreement, Nantahala received no credit for this benefit. Of course, the benefit accrued to Tapoco who passed the concealed benefit on to Alcoa.

(4) Nantahala's Entitlement for Operating Its Properties in Accordance with the Fontana Agreement

By the 1941 Fontana Agreement, Nantahala, at the instance of Alcoa, gave to TVA the right, *in perpetuity*, to control the storage and flow of water from its several hydroelectric projects. (See, Item 8, A.G. Popovich Cross-Examination Ex. 3 (original hearing)). Respecting the value of this right, the Fontana Agreement, at page 3, in part, states:

"Whereas, the most efficient and economical operation of the hydroelectric plants on the Tennessee River and the Little Tennessee River and their tributaries requires the closely coordinated operation of the system of Authority (sic, TVA) with Company's (sic, Nantahala & Tapoco) plants, and such coordinated operation will make possible substantial benefits and economies; and

"Whereas, operation under the provisions of this agreement will aid in the control of floods, the promotion of navigation, and the conservation of stored water; and . . ."

Unquestionably, Nantahala's giving up of rights constituted a loss of considerable value for which loss Nantahala has been entitled to compensation.

With the 1963 apportionment agreement between Alcoa and Nantahala (Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing), being also Exhibit WMJ-Rll), Alcoa agreed to continue to pay to Nantahala monies for Nantahala's loss of those operational rights. Moreover, the agreement clearly stated that TVA was continuing to pay value for those rights, which value is reflected in the TVA return entitlement of the New Fontana Agreement. The 1963 Alcoa-Nantahala Apportionment Agreement at pages 1-2, in part, states:

> "Whereas, the agreement dated August 14, 1941, known as the 'Fontana Agreement' has been superseded in certain respects by a new agreement dated December 27, 1962; and
>
> "Whereas, heretofore Nantahala has received certain payments which represented payments to Nantahala from operating its properties in accordance with the terms of the Fontana Agreement; and
>
> "Whereas, the above-mentioned agreement of December 27, 1962, (sic, NFA) was entered with the understanding among Nantahala, Alcoa and Tapoco, Inc. (a) that the benefits accruing to Nantahala thereunder would include the right to continue to receive payments equal in amount to the above-mentioned payments . . ."
>
> "*Now, therefore*, it is agreed that during the term of the above-mentioned agreement of December 27, 1962:
>
> "1. Alcoa shall pay Nantahala in monthly installments the sum of $89,200 per annum, which amount shall be in addition to the amounts otherwise paid by Alcoa to Nantahala for energy under such power purchase contract as shall be in effect from time to time."

Intervenors' witness Springs testifying on another aspect of this case, used language that is most appropriate to explain this matter:

". . . Thus, the Original Fontana Agreement still continues to confer significant benefits on Alcoa . . ." (Vol. 15, Tr. p. 27).

In the year 1963, in Docket No. E-13, Sub 13, the North Carolina Utilities Commission found the following facts concerning the TVA return entitlement as including a reimbursement to Nantahala. In Item 36, Applicant's Judicial Notice Exhibit (original hearing), at page 8, the Commission stated:

". . . The Evidence offered by Nantahala further disclosed that Nantahala operates under a working agreement between its parent, Alcoa, and TVA (the Fontana Agreement), wherein TVA exercises control of water release in the Nantahala generating system. For this privilege, TVA delivers to Alcoa approximately 25,600,000 Kwh at 100 percent load factor (compensation power) for the credit of Nantahala . . ."

At page 8, the Commission further stated:

"7. Alcoa pays Nantahala for TVA's control of the release of water in Nantahala's generating system at the rate of 3.5 mills per Kwh, based on 25,600,000 Kwh annually. This payment is below the rate paid by Alcoa to Nantahala for firm power."

Despite the fact that the NFA includes in the TVA return entitlement a reimbursement by TVA for the right to operate Nantahala's projects for which Alcoa previously paid $89,200 annually to Nantahala, when Mr. Popovich devised the 1971 Apportionment Agreement he gave no credit to Nantahala for that entitlement.

Under the terms of the 1971 Apportionment Agreement, Nantahala receives neither an energy credit nor a monetary payment for the right given up. Naturally, since the TVA payment for the operational rights, which is paid with energy in the NFA rate entitlement, did not go to Nantahala, it inured to the benefit of Tapoco. In turn, Tapoco passes this concealed benefit to Alcoa. (It should be noted that 3.5 mills has, for

many years, constituted far less than the present value of electric energy.)

(5) Nantahala's Value to the TVA Interconnected System

Another failure of the Apportionment Agreement respecting Nantahala's participation is that the Popovich formula does not consider the proper value to Nantahala of the fact that the Nantahala, Tapoco, and TVA systems are interconnected. Interconnection is of considerable value to TVA completely aside from the fact that Nantahala's rate base includes in it certain assets devoted to the interconnection, which assets are entitled to earn a rate of return. Because Nantahala is not an isolated system, it should be receiving the usual benefits that accrue from coordinated operation. Yet, Nantahala does not receive the usual benefits of an interconnected and coordinated system.

Intervenors' Exhibit DAS-23 consists of many pages of Alcoa memoranda reflecting the path of negotiation between Alcoa and TVA for the New Fontana Agreement. While there are several references to the matter of interconnection, we refer only to a few which illustrate that interconnection has considerable value. At page 28 of 85, one memorandum says:

> ". . . Copies of our studies were given to TVA and they showed that the new TVA proposal could be supplied from our present system without any apparent consideration given to gains that TVA will realize from integration and the peaking capacity on our system.
>
> "As mentioned above, TVA will check our studies on their own computer and if these studies are confirmed, we will have immediate discussions in an effort to determine what studies should be made to properly determine the benefits of integration, use of our peaking, etc. . ."

Again, on page 30 of 85, Intervenors' Exhibit DAS-23, an Alcoa memorandum states:

"II. *We do not believe present TVA proposal equitable because*:

a. Our system will alone produce the TVA proposal. . . . We argued, however, that TVA could realize advantages of integration, peaking, etc., and still provide their proposal to us from our system."

Again, on page 34 of 85 of Intervenors' Exhibit DAS-23, another Alcoa memorandum states:

"There is a strong feeling among the Engineering Department, particularly Messers. Gnuse, Tompkins, Eagleton, Popovich and others, that the value to TVA of integrated operation is much greater in 1960 than it was in 1941 at the time the contract was negotiated. They have argued that because of this, TVA should be willing to renegotiate the entire Fontana Agreement recognizing the present inequities. . . ."

Of course, during further negotiations, Alcoa was able to derive considerable gain from TVA for the integrated systems factor. We have previously mentioned certain benefits of a coordinated, integrated operation, such as the need for smaller reserves and, in this case, that TVA actually controls production of generation and storage waters.

However, we have not mentioned the value in integration of Nantahala's projects that are upstream of TVA's Fontana Project. In an integrated system such value is maximized. Since the Fontana Project is located below Nantahala's projects (See Intervenors' Ex. DAS-3) and above the Tapoco projects, other than Santeetlah, the Fontana Project receives the benefit of the storage capability of the Nantahala projects. Indeed, the TVA Tennessee River system receives the benefit of the storage of all of these projects located on the Little Tennessee River System. This is especially true since, under the New Fontana Agreement, TVA has control of all of these reservoirs on the Little Tennessee River system, except the three small projects of Nantahala which are not included. Intervenors' Ex. DAS-9 shows the results of a TVA study of downstream storage

benefits. According to this study, the Nantahala and Thorpe units alone added 12,400 Kw of continuous primary power to the TVA system. This is equal to 108,624,000 Kwh per year (12,400 x 8,760 hours) (Vol. 15, Springs pp. 48-49). We have already considered that the upstream Nantahala and Thorpe projects yield a continuous relative contribution to Tapoco's Calderwood and Cheoah projects of 4,300 Kw, which is 37,668,000 Kwh annually. This benefit to Tapoco should be deducted from Nantahala's total upstream benefit of 108,624,000 Kwh in order to obtain Nantahala's upstream benefit to TVA. After deduction, Nantahala's annual upstream benefit to TVA is calculated to be 70,956,000 Kwh.

Examination of the NFA reveals that the parties cancelled out their respective upstream benefits when that bargain was struck. Since Nantahala provided benefits upstream to both TVA and Tapoco, and TVA provided benefits upstream to Tapoco, it was Tapoco which gained by that mutual cancellation. Certainly, Nantahala lost the benefit of the value of 70,956,000 Kwh annually. Surely, Nantahala should receive in a joint agreement with TVA the benefit of that integrated upstream storage.

When the 1971 Apportionment Agreement was entered into between Tapoco and Nantahala, Tapoco should have been willing for Nantahala to have an additional 70,956,000 Kwh annually assigned to it as the value of integrated storage, but when Mr. Popovich devised the apportionment formula Nantahala got no such benefit. As a consequence, to Tapoco's benefit, Nantahala was deprived of one value of the interconnection with the TVA system. This concealed benefit flowing from Nantahala to Tapoco is, of course, passed on by Tapoco to Alcoa.

(6) Summary of Detriment to Nantahala from the 1971 Apportionment Agreement

By the 1971 Apportionment Agreement, Nantahala was given no credit for the following:

1.	Average production in excess of primary production	66,000,000 Kwh annually
2.	Benefits upstream of Tapoco	37,668,000 Kwh annually
3.	Entitlement for operating properties under Fontana Agreement	25,600,000 Kwh annually
4.	Value to TVA of the interconnected system	70,956,000 Kwh annually
		200,224,000 Kwh annually

In addition, Nantahala received no credit for its peaking capacity of 27,500 kilowatts over the 54,300 kilowatts assigned to it, for which Nantahala must pay demand charges to TVA when monthly demand exceeds assigned capacity.

The North Carolina Supreme Court, in *Edmisten*, *supra*, at pages 440-441, when considering just the failure of Nantahala to receive benefit for its average production, stated:

> ". . . Suffice it to say that the assertion that Nantahala's public is fairly served by a contract requiring Nantahala to purchase additional power regardless of the adequacy of its own generation *assaults the common sense of this Court* . . ." (emphasis added)

Now that considerably more of the various detriments to Nantahala have been exposed and fleshed out, it is apparent that the 1971 Apportionment Agreement works an extensive injustice on Nantahala and its public ratepayers, the gravity of which far exceeds even that envisioned by the Supreme Court.

B. *Concealed Benefits of the New Fontana Agreement*

The concealed benefits flowing from Nantahala to Alcoa by virtue of the New Fontana Agreement are entirely different from those previously discussed which flow from the 1971 Tapoco-Nantahala Apportionment Agreement. The basic inequity to Nantahala arising out of the NFA is that the energy entitlement returned to Nantahala and Tapoco from TVA is structured to meet Alcoa's demand for a certain amount of

stable electricity for purposes of aluminum production rather than a demand for a public load. Consequently, the NFA returns an average of 218,300 kilowatts of energy at a high load factor with minimal peaking deviation, which load is principally designed to service Alcoa's pot-lines and other production electrical requirements. Even the interruptible and curtailable energy entitlement returned to Tapoco-Nantahala is in increments of wattage that conform to the demands of a pot-line so that, if power is interrupted or curtailed, Alcoa can respond by cutting out a particular pot-line.

Nantahala, on the other hand, has a fluctuating demand for energy which has peaks and valleys. This is typical of a public service load. Nantahala's electrical requirement is for assured, but constantly, variable amounts. Nantahala needs peaking capacity and its generation projects possess peaking capacity, yet the NFA traded away that peaking capacity to TVA. The Intervenors urge that it would be ridiculous, as a result of enlightened, arm's-length bargaining, to turn over Nantahala's peaking capacity to TVA and then, at such time as its load requires peaking capacity, to buy that same capacity back from TVA at a very high price. The Commission agrees that the detriment resulting to Nantahala from the design of NFA flows to Alcoa as a benefit.

Intervenors' witness Springs testified as to the details of Alcoa's concealed benefits derived under the NFA (Vol. 15, Tr. pp. 39-46). He showed that Alcoa reaped enormous benefits through the improvement of the availability of Tapoco's secondary energy production *from* a level of 42% *average curtailment to an average curtailment* rate of only 8% (Vol. 15, Tr. pp. 39-40).

He also showed that the Tapoco generation statistics reflect the coordination of the Fontana Project and other forms of integration with TVA, which are inconsistent with the isolated system model utilized as the basis for the 1971 apportionment study (Vol. 15, Tr. pp. 43-44). As stated in a memorandum by George Popovich contemporaneously with the negotiation of the NFA:

> "It is my opinion that, to Alcoa, the present proposal (sic, NFA) represents an improvement over the existing Fontana Agreement. In day years this improvement could be substantial . . ." (Ex. DAS 23, p. 59 of 85)

Alcoa was in direct control of the negotiations, and, unlike the Nantahala ratepayers, has had every ability to protect its own interests during the negotiations (Vol. 15, Tr. p. 46-47). Respondents cannot now be heard to claim that they are dissatisfied with the NFA so as to place the cost responsibility for the deficiencies of that agreement upon Nantahala's ratepayers.

One reason the NFA may have been designed so exclusively to meet Alcoa's needs, to Nantahala's detriment, was because when the NFA negotiations were underway, the parties contemplated the sale of Nantahala's distribution system to Duke. By the sale to Duke, Nantahala would have been left with its generation but would have been without a public service load. Nantahala would then have taken its NFA entitlement and delivered it all to Alcoa. Accordingly, the power Nantahala would have gotten under the NFA would have been satisfactory for delivery to Alcoa irrespective of quantity and design.

A sale of Nantahala's distribution system to Duke had been approved by the North Carolina Utilities Commission and the approval Order, in turn, had been approved by the Superior Court. It was not until the year 1963 that the Supreme Court stopped the sale, which date was after the New Fontana Agreement had been executed. See *Utilities Commission v. Membership Corp.*, 260 N.C. 59, 131 SE2d 865 (1963). Prior to the Supreme Court's action, Alcoa personnel had believed that the sale to Duke was to be approved. Thus, in an Alcoa memorandum dated May 27, 1960, being Intervenors' Ex. DAS-23, p. 2 of 85, it is recorded:

> ". . . They (sic TVA) asked us the status of the sale of Nantahala to Duke. We told them that the matter was at a standstill at the present time but we were continuing our efforts to complete the transaction and we expected that

the sale would take place perhaps within the next year . . ."

In a memorandum of August 23, 1960, being page 15 of 85 of Intervenors' Ex. DAS-23, it is stated:

> "One final note, the entire TVA proposal is based upon the sale of the Nantahala Power Company. TVA proposed that if the sale was not complete at the time this new proposed contract becomes effective, they would increase the power available to us under the purchase contract to whatever amount is necessary for us to handle the Nantahala peak. This would be done on a temporary basis and would be reduced concurrent with the transfer of the Nantahala properties to Duke."

In another memorandum of November 6, 1962, being Intervenors' Ex. DAS-23, p. 83 of 85, which is the final memorandum after completion of all negotiations for the NFA, the following is written:

> ". . . In my opinion it will be preferable for us to sell the Mission Plant to TVA whenever we transfer the Nantahala properties to Duke . . ."

These memoranda clearly establish that during the entire 2 1/2 year period over which the NFA was negotiated between TVA and Alcoa, both parties contemplated that Nantahala's entire public service load would be sold to Duke. Based on this assumption, the entire TVA return entitlement to Alcoa was structured in such a manner as to meet Alcoa's load requirements for aluminum production. In no manner was the NFA structured to meet Nantahala's needs (Vol. 15, Tr. p. 47). We support this obvious conclusion even further by noting that on January 1, 1963, five days after the signing of the NFA, Alcoa and Nantahala executed an agreement between themselves to reflect "understandings" made between the affiliated companies at the time of the signing of the NFA. In this agreement, being Item 35, Truett, et al., Judicial Notice Ex. 1, also being Applicant's Exhibit WMJ-R11, it was stated:

"Whereas, the above-mentioned agreement of December 27, 1962 was entered into with the understanding among Nantahala, Alcoa and Tapoco, Inc. (a) that the benefits accruing to Nantahala thereunder would include the right to continue to receive payments equal in amount to the above-mentioned payments and, in addition, the right each month to an amount of energy which, together with its generation at plants not under said agreement, would be equivalent to its total actual generation but in no event less than one-twelfth of its annual primary generating capability, and (b) that certain obligations and benefits thereunder would be performed and enjoyed as herein set forth . . ."

The significance of this latter agreement is that since the NFA was obviously structured to Alcoa's need rather than to Nantahala's, Alcoa and Nantahala agreed that Nantahala could obtain certain power entitlements from the TVA return and, additionally, receive other monetary benefits from Alcoa.

Also, Intervenors' expert witness Springs testified, in part, as follows:

"Throughout the negotiations, TVA and Alcoa had every reason to assume that NP&L's distribution system would soon be sold off to Duke Power Company. NP&L did not even have a representative at any of the negotiating sessions. Alcoa secured the benefits of being integrated with TVA, including the benefit of storage releases from Fontana which are *vital to the operating of Tapoco's facilities*. . . . The 1963 Apportionment Contract shows in its face that the New Fontana Agreement was never intended as a 20-year power supply for NP&L public load. It appears that NP&L's officers and consultants were primarily concerned with the effect of the Agreement on the ongoing rate case and transfer cases before the NCUC and not with the interest of NP&L ratepayers over the 20-year period of Agreement." (emphasis added) (Vol. 15, Tr. p. 47)

The foregoing evidence of record clearly demonstrates that the NFA was tailored to meet Alcoa's aluminum production needs without consideration of Nantahala's public service needs, that the NFA return entitlement from TVA is not suitable for Nantahala's operations (although it is very suitable for aluminum production) and that Nantahala's participation in the TVA return entitlement could not be secured without a monetary supplement from Alcoa to Nantahala. The Intervenors have not established how much better Nantahala would have fared if the NFA had been negotiated for a TVA return suitable for servicing a public load, nor have they attempted to do so. Such proof is unnecessary. It is too hypothetical to conjecture as to what quantum and type of return energy Nantahala should have negotiated for and as to what TVA would have been willing to agree upon. Nantahala was not designed as, and is not in reality, a separate utility system but, rather, is part of an integrated Alcoa system with Tapoco. As expert engineering witness Springs testified:

> ". . . I agree with a rolled-in-cost-of-service approach for NP&L and Tapoco, because it is impossible to separate out the functional relationship between the generating resources operated by these companies and the load they each serve." (Vol. 15, Tr. p. 56)

Summarizing the foregoing inequities to Nantahala which result from the New Fontana Agreement, it can be stated that the TVA return entitlement was entirely designed for Alcoa's industrial load and was not suitable for Nantahala's public service responsibilities. Nantahala needed peaking capacity and had peaking capacity from its own generating stations, yet Nantahala gave up that capacity with the result that it must buy high cost power from TVA to meet its peaking responsibilities. The extra costs thus incurred by Nantahala inure to the benefit of Alcoa. For instance, by the 1963 Alcoa-Nantahala Apportionment Agreement, even Alcoa recognized, in fact, the unfairness to Nantahala produced by the NFA and agreed to pay an annual cash settlement of $89,200, to Nantahala to offset some of the inequities.

Any regulatory reformation of the NFA to properly award to Nantahala its just entitlements would, of necessity, be somewhat hypothetical. At this late stage of the case, and particularly with an alternative solution available, such reformation should not be attempted. The roll-in technique avoids the need for complete identification of inequities and is nicely suited as a proper alternative to reformation of contracts. The Supreme Court, in *Edmisten*, *supra*, at p. 443, called for use of the roll-in in this case, if beneficial to the public, with this language:

> ". . . This device does nothing more than recognize that the two corporate entities ought, for rate making accounting purposes, be treated as the one electrical power producing and distribution system which, in fact, they are. If then unlawful preferences are indeed accorded to Alcoa to the detriment of Nantahala's customers because of the separate corporate structures and the inter-corporate apportionment agreements, this ratemaking device would seem to eliminate them . . . . The case is remanded with directions to the Commission to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if this method of rate making were used and whether Nantahala's customers would benefit thereby."

Further, the Commission notes that while Nantahala's facilities were obligated as provided under the Original Fontana Agreement, it was not even permitted to be a signatory thereto. Even though it was a signatory to the New Fontana Agreement, it did not participate in the negotiations of that agreement. Moreover, Nantahala's employment contract with its president, William M. Jontz, provides, in pertinent part:

> "*Section 2. Duties and Responsibilities.* Employee is hereby employed by Nantahala as Chief Executive Officer of Nantahala and shall act in such capacities pursuant to the supervision and direction of the Board of Directors of Nantahala (hereinafter sometimes referred to as the

'Board'). Major general objectives of such employment during the term hereof are for the Employee to:

(a) Manage Nantahala as a public electric utility, within the restraints of regulatory controls, so as to achieve a profitability consistent with other public electric utilities in North Carolina.

(b) Develop plans for the possible sale or other disposition of Nantahala and execute such plans should the Board of Directors of Nantahala so direct.

(c) Accomplish (a) and (b) above so that there is little or no adverse impact on the operations and assets of Nantahala's parent company, Aluminum Company of America, and its subsidiaries in North Carolina, including, but not limited to, the generation and transmission of electric power by Tapoco, Inc. and Yadkin, Inc. and the operations of the Badin Works of Aluminum Company of America."

* * * * *

"*Section 3. Compensation.* For the performance on his duties and responsibilities, Employee shall receive the following compensation:

(a) *Base Salary* . . . (NOTE: this subparagraph is not further here quoted, but it provided for probable annual achievement awards.)

(b) *Achievement Award* to be determined annually by the three-member Aluminum Company of America group among the Board of Directors of Nantahala and to be based on the performance of Employee in reference to the major general objectives set forth in Section 2 hereof. The probable annual achievement awards for the respective contract years are set forth above."

* * * * *

"*Section 6. Nondisclosure.* . . . Nor shall Employee in any manner, directly or indirectly, aid or be a party to any

act, the effect of which would tend to divert, diminish or prejudice the good will or business of Nantahala or of Nantahala's parent company, Aluminum Company of America and its subsidiaries in North Carolina, Tapoco, Inc. and Yadkin, Inc."

As the record of this proceeding prior to remand established—and as the Supreme Court found (299 N.C. at page 435):

"The transmission facilities of Nantahala and Tapoco are integrated and interconnected into a single system. Alcoa controls the ultimate operation and accounting policies of both utilities. The chief executive officers of both Nantahala and Tapoco report directly to an Alcoa vice president. Members of the board of directors of both utilities are employees of Alcoa."

Alcoa's dominance is obviously and frequently documented in the results of various arrangements it has caused Nantahala and Tapoco to enter into. Such dominance has caused detriment to Nantahala and has resulted in the passing of concealed benefits to Alcoa.

Therefore, based upon the foregoing and upon careful consideration of the entire evidence of record, the Commission concludes that it should reject the companies' proposed allocation methodology in that said methodology in all material respects is based upon the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement.

Before going forward with a specific discussion of the Intervenors' allocation methodology, it is appropriate to examine two questions which were vigorously contended as between Alcoa and Tapoco on the one hand and the Intervenors on the other hand:

First, does Tapoco wheel power for Alcoa?

The companies (Alcoa and Tapoco) contend that the $31 million of power purchased by Alcoa directly from TVA can become a part of the Nantahala-Tapoco system simply because

the power was allegedly "wheeled" by Tapoco from TVA to Alcoa.

Alcoa purchases supplemental power from TVA. Alcoa and Tapoco contend that the TVA purchased power is wheeled to Alcoa through Tapoco's facilities. The Intervenors rigorously dispute this contention on the grounds that there is neither wheeling in fact, nor a contract between TVA and Tapoco, nor Alcoa and Tapoco, nor Alcoa and TVA for Tapoco to perform wheeling services, nor is there a charge made for wheeling services.

Company witness Buchanan, "an accounting executive with the title of Assistant Controller-Financial Accounting" for Alcoa (Vol. 2, Tr. p. 86), testified that:

> ". . . As Assistant Controller of Alcoa, I have general responsibility for the financial accounting for Alcoa and its subsidiaries, and as such have responsibility for the books and records and financial policies of Tapoco and Nantahala." (Vol. 2, Tr. p. 87)

On cross-examination he was asked:

> "Q. Does Tapoco ever receive a fee for the wheeling service you have just described?
>
> A. I'm not aware of any fee, no, sir." (Vol. 2, Tr. p. 143)

Immediately after that testimony, Company Counsel Jones argued:

> ". . . that the record in this proceeding carries with testimony of the earlier witness, Mr. George Myers, President of Tapoco, a complete description of the wheeling, recognition that the wheeling is pursuant to Tapoco's FERC rate schedule No. 4, I believe it is, although the record will speak for itself . . ." (Vol. 2, Tr. pp. 143-144)

However, reference to the prior testimony of Mr. Myers fails to bear out Counsel Jones' contention. Mr. Myers had testified:

"Q. Do you know whether Tapoco has an FERC rate schedule covering its wheeling of Alcoa's purchases from TVA to the other two plants?

A. I guess I'm not familiar with what that rate schedule is. I know the basis on which it is done but I don't know the exact rate schedule." (E-13, Sub 29, August 29, 1980, Vol. 1, Tr. pp. 65-66)

Switching back to accounting officer Buchanan, inquiry was made of him as to whether he could identify the alleged wheeling contract. On cross-examination Mr. Buchanan testified:

"Q. All right. Now, you are saying then I gather that Tapoco transmits TVA to Alcoa. Is that correct?

A. Yes, sir.

Q. All right. Now, will you tell the Commission, please, sir, on what agreement you rely for making that statement and have you seen that agreement?

A. I have not seen the agreement.

Q. You don't know it to be a fact, do you?

A. No, sir." (Vol. 2, Tr. p. 139)

Thus we observe that neither the President nor chief financial officer of Tapoco was familiar with the alleged wheeling contract. Moreover, if there is a wheeling contract, certainly it does not provide compensation to Tapoco for any wheeling service performed.

Wheeling has a particular definition. In *Town of Norwood v. FERC*, 587 F.2d 1306 (1978), at page 1307, Note 2, the Court defined wheeling this way:

". . . wheeling is an industry term which denotes the use of one utility's transmission facilities to transmit from another utility."

In *Idaho Power v. FPC*, 346 F.2d 956 (1965), at page 957, Note 1, the Court said:

> " 'Wheeling' is the transmission of one company's power over another company's system."

And, see *Utah Power & Light Co. v. Morton*, 504 F.2d 728 (1974).

These definitions of "wheeling" are compatible with the definition of "wheeling" within the electrical industry. Thus, within the electrical industry "wheeling" is defined as follows:

> "Wheeling service—the use of the transmission facilities of one system to transmit power of and for another system." (Intervenors' Judicial Notice Ex., Edison Electrical Institute, "Electric Utility Rate Making and Load Management Terms," dated Sept. 11, 1978, p. 83)

The companies (Alcoa and Tapoco) subsequently had their witnesses identify a contract between Alcoa and Tapoco as the one governing the alleged "wheeling" arrangement. Buchanan testimony, Vol. 3, Tr. pp. 1-2; Vander Veen testimony, Vol. 4, Tr. pp. 2, 11-14. However, that contract (Intervenors' Buchanan Cross Exam. Ex. 2) does not mention either "wheeling" or "transmission" to support the companies' position. Instead, the witnesses must interpolate other words as including within their framework "wheeling." Such interpolation was accomplished by accounting witness Buchanan in this fashion:

> "Q. I will hand you the document, sir, and ask you, please, to point out to me wherein in this document you find language that supports that characterization of it, please?
>
> A. The contract reads to the effect under which power delivered to Alcoa, Tapoco and other sources, is transferred and switched at the high voltage substation facilities of Tapoco, located adjacent to the Alcoa, Tennessee, works of Alcoa. And it is my understanding that that relates to the wheeling between the various plant locations of the Alcoa, Tennessee, plant.
>
> Q. That is your understanding. It doesn't say that, does it?

A. Not in those words, no, sir.

Q. It doesn't say that in any words, does it?

A. No, sir." (Vol. 3, Tr. pp. 2-3)

Company Witness Vander Veen testified that transforming and switching constituted the alleged wheeling.

"Q. . . . I'm going to read to you, sir, the initial paragraph lower case 'a.' quote, 'At the substation facilities mentioned above, Tapoco will perform such necessary transformation and switching of power delivered to Alcoa as Alcoa shall direct.' End quote. I ask you first, sir, is there anything in that language that relates to transmission?

A. Yes, sir. Those functions, the switching functions, if I could see the word please. Yes, such necessary transformation and switching of power—

Q. (Interposing) Transformation?

A. Transformation and switching, those are transmission functions, sir." (Vol. 4, Tr. p. 5)

Later, the so-called wheeling was pin-pointed to a single location.

"Q. Does either pay the other any wheeling charge whatever for the transmission of that power from any generating source to the Tapoco substation?

A. The wheeling is at the substation.

Q. That's the only point?

A. Yes, sir." (Vol. 4, Tr. p. 11)

The Agreement is not in actuality a wheeling agreement since "wheeling" requires transmission and the agreement is dealing with transformation and switching.

In actuality, there is no wheeling of power for Alcoa or TVA by Tapoco.

In further support of this position, the Commission takes note of the fact that Tapoco sells all of its power, i.e., its NFA

return entitlement from TVA, to Alcoa. Intervenors' Buchanan Cross-Examination Ex. 3 is that 1963 sales arrangement.

The companies urge that the Alcoa purchases from TVA be considered in the Nantahala-Tapoco electrical system as the result of the following paragraph in the alleged wheeling contract from Tapoco to Alcoa.

> "It is desirable to reduce to writing the arrangement between Tapoco, Inc. (Tapoco) and Aluminum Company of America (Alcoa) under which power delivered to Alcoa (from Tapoco and other sources) is transformed and switched at the high voltage substation facilities of Tapoco, located adjacent to the Alcoa, Tennessee works of Alcoa. Accordingly it is proposed that we agree as follows:" (Intervenors' Buchanan Cross-Examination Ex. 2)

For accounting purposes that contractual language obviously doesn't carry with it a wheeling obligation since no wheeling fee is collected. Even the president of the company isn't aware of a wheeling obligation by virtue of that contract. Even if the contract marginally constitutes a wheeling arrangement, it should not be used as a ploy to dump Alcoa's purchases from TVA into the Nantahala-Tapoco electrical system.

Perhaps the truth of the separateness of Alcoa's TVA purchases from the Nantahala-Tapoco system is best summed up by this honest and final testimony of the companies' witness Dr. Leininger when he testified:

> "Q. All right. Now you say each must employ additional TVA power to meet its customers' total load. When you make that statement, are you saying that Tapoco supplementally to the entitlements it gets out of the Fontana Agreement must acquire TVA power to supply to Alcoa?
>
> A. I suspect its inartful wording. Alcoa does its own purchasing as I understand it.
>
> Q. Did you understand that when you wrote this sentence?
>
> A. Yes, sir.

Q. Why did you write it this way then?

A. Because I wasn't careful when I wrote it." (Vol. 14, Tr. p. 97)

Therefore, based upon the foregoing and other evidence of record, the Commission concludes that it would be completely erroneous to find either (1) that the Alcoa purchases from TVA are "wheeled" by Tapoco to Alcoa or (2) that such power, if wheeled, enters into and becomes a part of the Nantahala-Tapoco unified public utility system.

The second question is: Are Alcoa's purchases of power from TVA part of the Nantahala-Tapoco integrated system?

The record reflects, during the year 1975, that Alcoa bought some $31 million in electric power from TVA which Alcoa used solely for its industrial plant operations in Tennessee. The record establishes without dispute that neither Nantahala nor Tapoco generated, bought, sold, acquired, or had any right to use that electricity. Alcoa retained 100% control over such power at all times. Where Nantahala and Tapoco, as public utilities, do not generate, acquire, buy, sell, or have the right to control the use of electric power, no such ungenerated, unacquired, unbought, unsold, and uncontrolled power can be a part of the Nantahala-Tapoco public utility system.

However, assuming *arguendo* the companies' contentions regarding wheeling are correct there is no showing that the power is at all integrated with the combined system. The further issue is whether the power purchased by Alcoa directly from TVA has become available to the Nantahala-Tapoco system to meet its public service load. If Tapoco had any contact at all with the Alcoa purchases from TVA, at most, the Tapoco activities are limited to Transforming and Switching, which activities do not rise to the level of transmission as required for wheeling. However, if it is assumed, again for purposes of argument, that Tapoco did "wheel" the Alcoa Power purchased from TVA, such power should not be treated as a part of the Nantahala-Tapoco unified system because the power never entered into the Nantahala-Tapoco unified system. Even if the TVA power enters Tapoco's substation at

Alcoa, Tennessee, such power does not traverse the Nantahala-Tapoco electrical system. Instead, at most, that power is released by TVA at the Alcoa substation where it is transformed and immediately switched over to Alcoa's lines. Such power could never be made available to serve any portion of the public service load. Most fundamentally, its identity as Alcoa power is never lost since Alcoa never releases control of the use of that power in its capacity as ultimate consumer of that power from TVA.

The contract between Alcoa and TVA (Company Exhibit BDC-3) does not mention delivery of the TVA purchased power by the Nantahala-Tapoco system but rather describes delivery direct to Alcoa. Page 2, paragraph 3, of the contract reads as follows:

> "3. *Delivery of Power.* Power delivered hereunder shall be 3-phased alternating current at a frequency of approximately 60 cycles per second and shall be delivered at company's Alcoa Primary Substation at a nominal voltage of 162 Kw or such other voltage as may be agreed upon by the operating representatives. Except for temporary periods of abnormal operating conditions, voltage variations will not exceed 5 percent up or down from the normal voltage."

Even when interpreting "Company's Alcoa Primary Substation" to mean a Tapoco substation, obviously Alcoa does not lose any control over that purchased power by permitting it to become a part of the Nantahala-Tapoco unified system.

Moreover, Alcoa does not pay a fee, even a nominal one, to Tapoco for the so-called "wheeling" service—if there is a "wheeling" service. This is made clear by the testimony of companies' witness Buchanan.

> "Q. Then Tapoco, the combined Nantahala-Tapoco system or entity, however you want to characterize it, neither billed nor received a penny with respect to TVA sales to Alcoa. Isn't that correct, sir?

* * * * *

"A. You are correct in the statement in the manner in which you said it. Yes, sir—." (Vol. 2, Tr. pp. 118-119) (See, Vol. 2, Tr. p. 134)

Additionally, Tapoco failed to report on its Form 1 to FERC that it wheeled $31 million of power to Alcoa (Vol. 2, Tr. p. 134). One reason for this "failure" is that TVA bills Alcoa directly for the power. Tapoco does not become involved with the purchased power, either financially or through line losses.

The Commission, based upon the foregoing and other evidence of record, concludes that purchases of power from TVA by Alcoa are not cost applicable to the Nantahala-Tapoco integrated system properly assignable in any way to said system's North Carolina retail operations.

Allocation of the costs of the Nantahala-Tapoco unified system involves several aspects, namely, (a) allocation of the $31 million of Alcoa purchases from TVA and (b) the mathematics of allocation. We will treat these two items separately.

A. *Allocation of the $31 Million of Alcoa Purchases From TVA*

The Intervenors contend and the Commission concurs that should the $31 million of Alcoa purchases from TVA be rolled into the Nantahala-Tapoco unified system, those purchases should be allocated entirely to Alcoa.

To illustrate the necessity of the allocation entirely to Alcoa, let us suppose that Tapoco purchased the power in question under a contract identical to the Alcoa-TVA contract. In such an instance there is no way in which that contract can be turned from a specific requirements contract into a general requirements contract. The Alcoa-TVA power purchase agreement (Applicant Exhibit BDC-3), at page 2 (discovery p. 200082), states:

"2. *Availability of Power.* Subject to the other provisions of this contract, TVA shall make available to Company hereunder 'firm power' in the respective amounts specified for the periods indicated in the tabulation set

forth below, which amounts shall be 'firm contract demand' under this contract for such periods.

	Amount of Firm Power Available
August 1, 1969, through December 31, 1972	30,000 Kw
January 1, 1973, through July 31, 1979	350,000 Kw

Except as otherwise provided in this contract, TVA will make power available to company continuously hereunder during each of the above periods in the amount of the firm contract demand specified for that period. The firm power available hereunder will be deemed to be taken and used by the Company at 100 percent load factor."

The terminology of the contract is not suitable for a public utility load, which needs variable amounts of energy, but rather is suitable only for a specific customer having stable needs. Thus, even if the contract were considered to be a Tapoco contract, the contract is so tailored to a specific customer that the costs associated with it would have to be specifically assigned to the customer. This logic is confirmed by the testimony of Intervenors' witness Springs wherein, on cross-examination by the companies, he testified:

"Q. That power was purchased for that one customer, is that right?

A. That is right. It would be a pass-through because it is identified as related to that customer. It is not a function of a utility." (Vol. 15, Tr. p. 81)

In this case, in order to escape a specific or pass-through assignment of costs of the TVA purchases to Alcoa, the contract would have to be modified to be a Tapoco purchase contract with modified terms providing for power amenable to a public utility operation. Neither of those facts has or will

happen. For purposes of this case, the companies are bound to the existing contract to which Tapoco is not a party and which is an Alcoa specific requirement rather than a general requirements contract. As companies' witness Cockrell testified:

> ". . .Alcoa purchases Tapoco's entitlements and acquires the remainder of its needs from TVA under a companion contract." (Vol. 5, Tr. p. 62)

Alcoa is not a small industrial company which would have only a marginal effect on Nantahala but rather a massive company with worldwide operations. Gross revenues in 1980 were $5.2 billion (Vol. 2, Tr. p. 110), which amount is more than 300 times the gross revenues of Nantahala. The Alcoa, Tennessee, aluminum reduction facilities, as late as 1952, when the book *An American Enterprise* was written (Intervenors' Exhibit DAS-1, p. 1 of 14), was the largest in the world. (Intervenors' Exhibit DAS-1, p. 8 of 14). Furthermore, the Alcoa, Tennessee, aluminum reduction plant is merely one of many for Alcoa. See Applicant's Exhibit BDC-1 for a list of Alcoa's nine aluminum production plants which have an annual average need of 28,557,600,000 Kwh of electricity (3260 Mw x 24 x 365). By way of comparison, Alcoa's annual aluminum production need for electricity approaches in size the combined North Carolina production of both Duke Power Company and Carolina Power & Light Company.

Alcoa is a gigantic energy consuming entity nationwide and its impact on western North Carolina is likewise enormous. If the Alcoa, Tennessee, load that is purchased from TVA were to be assigned as a function of the Nantahala-Tapoco system, the impact of that load on the system would be so enormous as to warp and twist the costing technique of the entire system. Indeed, if the Nantahala-Tapoco system tried independently to service the Alcoa-Tennessee load, it would have to double its system size. Yet no effort has been made by the system to do that. Neither Nantahala nor Tapoco has built a facility in over 20 years. Alcoa is entirely dependent upon TVA for its supplemental load.

B. *The Mathematics of Allocation*

Although the Commission has previously rejected the companies' use of demand and energy entitlements contained in the NFA and the Apportionment Agreement as a basis for the derivation of demand and energy allocations, the Commission believes that the manner in which the companies employed the data contained in said agreements is worthy of further comment.

The NFA return entitlement from TVA is an annual average of 218,300 Kw of which Nantahala is assigned 41,300 Kw leaving the balance, less line losses, for Tapoco. While 90 Mw of the entitlement is curtailable for as long as five months annually, total energy curtailed is limited to 1,260,000,000 Kwh during the entire 20-year term of the agreement (Item 9, A.G. Popovich Cross-Examination 4, pp. 6-7). Of course, if power is curtailed in one year it will have to be made up in the other years in order for TVA to supply an annual average of 218,300 Kw over the 20-year term. Despite this, for allocation of demand costs to Tapoco when computing the system peak, Company witness Vander Veen did not include any portion of the 90 Mw curtailment entitlement for determining the peak demand upon the system. Witness Vander Veen testified:

> ". . .Consequently, for demand cost allocation purposes, I used only firm power available to meet system peak, thus removing the amount of capacity that can be curtailed and interrupted from the capacity available to serve system peak load. . . ." (Vol. 3, Tr. p. 71)

The upshot of this technique is to render the 90 Mw valueless for meeting the system demand at any time, even during years when there is no curtailment and, indeed, when there may be additional make-up demand.

Mr. Vander Veen also took out of the Tapoco demand allocation 1/6th (i.e. 15 Mw) of the 90 Mw interruptible power returned by TVA under the NFA. A total of 105 Mw was thus taken out of Tapoco's demand allocation for both the curtailable and the interruptible power (Vol. 3, Tr. p. 71).

The effect on Nantahala of Mr. Vander Veen's technique will be to dramatically increase Nantahala's proportionate share of the demand charges. A careful analysis of Mr. Vander Veen's allocation calculation shows the following: His system peak is 430.2 Mw, as to which there is improperly included 235 Mw representing Alcoa's TVA purchases. If we deduct the 235 Mw from the system peak of 430.2 Mw, we obtain a Nantahala-Tapoco system peak of 192.20 Mw of which Mr. Vander Veen calculates Nantahala's share to be 107.2 Mw while Tapoco's share is only 88 Mw (Vol. 3, Tr. p. 72). Thus, Nantahala must share a considerably higher demand allocation than Tapoco even though Nantahala and Tapoco both take under the NFA and Tapoco takes three times as much power as Nantahala.

Witness Springs explained how Mr. Vander Veen's approach unfairly burdens the public customers by requiring them to bear costs properly assignable to Alcoa.

> "Mr. Vander Veen assigns customer cost by utilizing the entitlements of the New Fontana Agreement to derive the system demand instead of utilizing the total demands placed upon the Tapoco and NP&L generation. Although the New Fontana Agreement reshaped the available power supply to suit Alcoa's load requirements, the entitlements result from the investment, maintenance, and operation costs necessary to make the hydroelectric generation of NP&L and Tapoco available for TVA's demands.
>
> The fallacy of Mr. Vander Veen's approach is illustrated by the demand credit he assigns to Alcoa because of the interruption and curtailment features of the New Fontana Agreement entitlements. This is a misapplication of an allocation principle. Although it is not unusual for an industrial customer to receive a credit for accepting interruptible power, the rationale for this is that the utility providing the service to that customer will save the cost of carrying reserves. The ability of a utility to provide such credits is limited by its need for reserves. There should be no credit for interruptions which do not result in cost savings to the supplying utility. Mr. Vander Veen's demand credit unfairly assigns to other customers the fixed costs necessary to generate the power traded to TVA for this

curtailable and interruptible power. The fixed costs of investment, operation, and maintenance for these plants do not cease when TVA curtails delivery to Alcoa under the New Fontana Agreement contractural arrangements." (Vol. 15, Tr. pp. 59-60).

Mr. Vander Veen arrived at his allocations based upon the premise that the NFA and the 1971 Apportionment Agreement were negotiated in the best interest of Nantahala's public service load. Nothing could be further from the truth! (Vol. 15, Tr. p. 39)

The NFA was entered into for and structured to meet Alcoa's load requirements. Nantahala was not even present during negotiations (Intervenors' Exhibit DAS-25). In essence, the NFA is a trade-off of certain firm power and secondary power, available less than 50% of the time, for lesser amounts of firm and secondary power that are curtailable and interruptible but available more than 50% of the time, since any power available more than 50% of the time is useable by Alcoa in its aluminum smeltering operations (Vol. 15, Tr. p. 40). The trade-off result is a considerable improvement in the value of Tapoco's energy useable for Alcoa's aluminum production (Vol. 15, Tr. p. 45). The trade-off has no value to the public load. Alcoa (Tapoco) should, therefore, take full cost responsibility for the demand-related costs associated with the capacity traded off (Vol. 15, Tr. p. 61).

The Vander Veen demand allocation technique would result in a gross inequity to Nantahala and to public load customers. A proper allocation technique should not be inequitable either to Nantahala or to Tapoco.

With the terms of the NFA having been structured to meet Alcoa's industrial needs and not Nantahala's public service needs, it is improper to allocate demand and energy costs based upon the TVA return entitlements. Rather, demand and energy charges should be based upon the capabilities and the needs of Nantahala and Tapoco outside of the TVA return entitlements. That is the very purpose of the roll-in study.

The combination of the NFA and the 1971 Apportionment Agreement forces Nantahala to purchase additional power irrespective of its production capacity. We reiterate what the

Supreme Court said in *Utilities Commission v. Edmisten*, *supra*, at page 440:

> ". . .Suffice it to say that the assertion that Nantahala's public is fairly served by a contract requiring Nantahala to purchase additional power regardless of the adequacy of its own generation assaults the common sense of this court. Nantahala's customers should not be denied the benefit of their utility's fairly regular harvests of abundant energy."

The Commission also points out again that the purpose of the roll-in method of ratemaking is to "cancel" or at least to "true-up," concealed benefits. See, *Utilities Commission v. Edmisten*, *supra*, at pages 437-443.

The Intervenors contend that the following data represents the capabilities and needs of the Nantahala-Tapoco unified system, and that such data is appropriate for use in the allocation of demand-related costs.

A.	Dependable Capacity for NP&L Projects (See Intervenors' Exhibit DAS-4)	85.4 Mw
B.	Dependable Capacity of Tapoco Projects (See Intervenors' Exhibit DAS-4)	302.8 Mw
C.	Total (A + B)	388.2 Mw
D.	Less Reserve at 3%	11.3 Mw
E.	Net *Firm* Capacity Available to Meet the Load (C-D)	376.9 Mw
F.	Purchase Power of NP&L from TVA (NP&L FPC Form No. 1, 1975, page 422)	50.4 Mw
G.	Losses on F above (assumed 5%)	2.5 Mw
H.	Total Net *Firm* Capability Available at Generation to Meet the System Requirements of NP&L and Tapoco (E + F + G)	429.8 Mw

See Vol. 15, 54, p. 62.

Nantahala's peak load during the test year was 105,747 Kw which figure represents its maximum need during the year. Nantahala's demand responsibility for costing purposes can be calculated by dividing the total Nantahala-Tapoco system demand responsibility into Nantahala's maximum demand responsibility. Thus, dividing 429,800 Kw into 105,747 Kw produces a Nantahala demand allocation of 24.60% of the system's demand responsibility (Vol. 15, Tr. p. 63). Using this allocation factor, 24.60% of the Nantahala-Tapoco unified system demand costs should be assigned to Nantahala and the balance to Tapoco.

While demand charge allocations must be computed based on production capacity and capacity needs, energy charge allocations must be computed based upon the average energy available for the Nantahala-Tapoco unified system plus Nantahala's purchases. The Intervenors contend that the following data represent the average energy available to the combined system including Nantahala purchases, and that such data is appropriate for use in the allocation of energy-related costs.

A.	Average Energy Available from NP&L Projects (New Fontana Agreement Apportionment Study) (Intervenors' Exhibit DAS-12)	391,500 Mwh
B.	Average Energy Available from Tapoco's Projects (New Fontana Agreement Apportionment Study) (Intervenors' Exhibit DAS-12)	1,373,600 Mwh
C.	Total Average Energy Available from NP&L and Tapoco's Projects (A + B)	1,765,100 Mwh
D.	NP&L Purchase of Energy from TVA (NP&L Form No. 1, page 422)	81,265 Mwh
E.	Losses on D above (assumed 5%)	4,063 Mwh
F.	Total Average Energy Available to Meet System Load (C + D + E)	1,850,428 Mwh

See Vol. 15, Tr. pp. 63-64.

Nantahala's energy requirement during 1975 was 453,548 Mwh. Nantahala's energy responsibility for costing purposes can be calculated by dividing the total Nantahala-Tapoco system energy responsibility into Nantahala's energy responsibility. Thus, dividing 1,850,428 Mwh into 453,548 Mwh produces a Nantahala energy responsibility of 24.51% (Vol. 15, Tr. pp. 64-65). Using this allocation factor, 24.51% of the Nantahala-Tapoco unified energy costs should be assigned to Nantahala and the balance to Tapoco.

The demand allocation factor of 24.60% and the energy allocation factor of 24.51% were used by Intervenors' expert witness Solomon in allocating the Nantahala-Tapoco total system demand and energy-related costs to said system's North Carolina retail operations.

The Commission, after having very carefully considered the entire evidence of record with respect to the assignment of cost including cost allocation techniques and/or methodologies, concludes that the methods and procedures employed by the Intervenors with respect hereto are, in all material respects, proper and that said methods and procedures should be adopted for use herein.

* * *